OPERATING ASPECTS OF INDUSTRIAL MERGERS

WILLIAM R. BASSET

IOWA STATE COLLEGE
of
Agriculture and Mechanic Arts
LIBRARY

Book No. HD2795
B294o

Accession No. 187862

Operating Aspects
of
Industrial Mergers

Operating Aspects of Industrial Mergers

BY

WILLIAM R. BASSET
Member of the firm of Spencer Trask & Company

IN COLLABORATION WITH
JOHNSON HEYWOOD

HARPER & BROTHERS PUBLISHERS
NEW YORK AND LONDON
1930

OPERATING ASPECTS OF
INDUSTRIAL MERGERS

Copyright, 1930, by
HARPER & BROTHERS

Printed in the U. S. A.

First Edition

D-E

HD2795

CONTENTS

	Foreword	vii
I.	Why Merge?	1
II.	Types of Mergers	20
III.	Production Economies of Mergers	36
IV.	The Distribution Economies of Mergers	56
V.	The Administration Economies of Consolidation	73
VI.	Putting a Merger Together	91
VII.	The Financial Structure	112
VIII.	Management Problems a Merger Must Solve	136
IX.	Mergers and the Anti-trust Laws	161
X.	Where is the Merger Movement Leading?	180
XI.	A Brief History of Merger Movements	194
	Index	201

197862

FOREWORD

BY carefully choosing cases one group proves, to its own satisfaction at least, that merging is a panacea which will rejuvenate any business no matter how decrepit or any industry no matter how senile. Another group, reasoning from equally carefully selected cases, comes to the conclusion, which evidently suits its purpose, that all mergers are basically unsound and are doomed to fail. This, in spite of the rather notable success of quite a few hundred.

One school of thought maintains that only by consolidating with others can the small concern hope to survive, while another, strangely enough, cites statistics to prove that small concerns are more efficient than large ones and therefore easily beat out their giant competitors.

It is manifestly ridiculous to generalize from selected instances. As usual, the whole truth is not to be found in either partisan extreme. It must be evident, even to the casual observer, that there are wisely conceived and well-managed mergers which are highly successful. Some of these have been built up of formerly not-so-successful concerns. Others, unsoundly conceived or poorly managed, have been less successful than were the component companies operating independently.

It is our purpose in this book to set down without partisanship the basic facts about mergers in the industrial and merchandising fields, leaving out of consideration mergers of banks, railroads or public utilities.

It is not our intention to write a history of any particular mergers, although we cite specific instances whenever they will throw light upon basic economic factors which affect the soundness of consolidations.

In brief, it is our aim to make this book of practical and definite value to business men who may be contemplating what consolidation might accomplish for them and to officers of existing mergers which for one reason or another have not turned out to be as successful as was hoped. It deals more with practical problems of promotion and operation than with finance—although the fundamental principles of sound merger financing are necessarily touched upon.

Because it deals at some length and in considerable detail with the factors that determine whether a merger is economically sound, this book should also be of value to the investor in helping him to judge whether an investment in the securities of any merger is apt to prove profitable or unprofitable.

For the sake of simplicity we refer to all groupings of industrial properties under a common control as "mergers." Even those old combinations under the trust form are called mergers. It would be easy to split hairs over the use of such terms

as "merger," "consolidation," "combination" and "amalgamation." But nothing is gained thereby.

By "merger" we describe the acquisition of one company by another—the purchaser being either an operating company or a holding company or both. The acquisition may be made by purchase of assets, by purchase of all capital stock, the purchase of controlling stock interest or even of less than control. The centralized control of operations and policies in the common interest of several companies is, in the opinion of the authors, all that is necessary to warrant the description of a group of concerns as a "merger."

Parts of certain chapters were first published as articles in the *World's Work, System, Factory and Industrial Management* and *Printers Ink.*

Operating Aspects
of
Industrial Mergers

Operating Aspects of Industrial Mergers

CHAPTER I

Why Merge?

IT is held in some highly uninformed quarters that the recent great increase in the number of mergers is principally due to investment bankers who, in order to have securities to sell, are willing to sponsor and finance almost any assortment of business cats and dogs that a fluent promoter tells them can be consolidated. If that were true there would be probably a hundred times as many mergers as there are. Roughly, not more than one in a hundred of the proposed mergers offered to a careful banking house meets its requirements as to basic economic soundness.

The fact is that mergers are a natural, indeed an inevitable, result of recent economic trends. The successful mergers are those that are in harmony with these trends.

Seeing their success, but not fully understanding the why of it, uncritical business men seem to assume that there is some magic quality inherent in merging which will unfailingly transform any aggregation of individual businesses into a successful consolidation.

Thus, not long ago we were treated to the sight of a merger of concerns as little related as would be a peanut stand, a barber shop, a book store and an undertaking parlor. Apparently the only reason for putting together this almost ludicrous "merger" was that the biggest company, having some spare cash, embarked on a shopping orgy and bought practically everything in sight so long as its money lasted.

There probably is no reason why any company should not, if it wishes, buy into wholly unrelated enterprises. But certainly it is not justified in claiming for such a hodgepodge the advantages that accrue to a soundly conceived and logically put together merger.

What are the economic developments that account for the present marked tendency to merge?

First and foremost is the acceptance by American business men of the fact that the combination of low prices and high wages is not only possible but highly desirable from the standpoint both of labor and of business. Intelligent business men seek constantly for ways by which they can still further reduce the price which the consumer must pay for goods. Much has been accomplished by improving production methods, but there still remain great wastes over many of which the small independent concern has little or no control. To secure the ultimate in cost and price reduction, it is necessary to eliminate every unnecessary item of cost between the raw material as nature provides it and the ultimate consumer. The proper kind of merger pro-

vides a most effective means for reducing many elements of the costs of production, distribution and administration.

This reason for merging is in marked contrast to that which underlay the mergers of thirty to forty years ago, whose promoters and managers thought they saw in consolidation a way to monopolize their industries to the end that prices to the consumer might be jacked up sky-high.

Another potent cause of mergers is the acute competition which results from so-called "overproduction." Theoretically, until every inhabitant of the world has all of the goods of all kinds that he can use, there can be no such thing as real overproduction. What we really have is underconsumption, due to the fact that millions of people cannot yet afford to buy what the factories can produce, largely because the factories cannot produce at low enough cost.

In practice, under normal conditions, we have in many industries a certain amount of actual or potential overproduction. Much, if not all, of this excess capacity consists of antiquated high cost plants which cannot compete with the modern low cost ones and so can operate at a profit only during the infrequent periods when prices are abnormally high.

Owners of inefficient old mills are naturally reluctant to wipe out their investment by junking their properties. As a result, they constitute potential capacity hanging over the market ready to provide overproduction at the moment prices show

symptoms of stiffening. Many such plants operate more or less continuously. Not only do they tend to disorganize their own industry; they usually pay low wages, which is still worse because that directly or indirectly affects adversely the prosperity of everyone.

In some cases the only way an industry can be relieved of the threat of high-cost, antiquated productive capacity is by means of mergers, large enough and rich enough to buy up such plants and junk them. Expensive as this procedure is, it is sometimes less expensive in the long run than to combat ill-informed and sometimes ill-natured and downright malicious competition.

A large merger in one industry took that view. It wiped out its investment of several million dollars in inefficient factories—with great courage junking nearly half of its plants.

The American Writing Paper Company, a merger formed in 1899, struggled along until 1927 with 26 plants, some of which were none too efficient. The entire production could be turned out at a proper cost by 16 of the more efficient mills operating at close to capacity. The inefficient plants operated only at intervals but their overhead expense went on full time and was a serious drain on the company—so serious that in 1927 it underwent a complete reorganization. As part of the betterments put into effect, ten of the mills were turned over to a separate company and offered for sale. Of the nine that have so far been sold, two were taken for their water power, five are making entirely non-

competitive products and two, while making a product somewhat similar to that of the American Writing Paper Company, are so located geographically as not to be competitors. It is likely that had the American Writing Paper Company followed this plan when it was first put together thirty years ago, its history might not have been so spotty. But we know more about the economics of merging now than we did then.

It is not only by eliminating obsolete plants that mergers tend to reduce the likelihood of overproduction.

Even in the face of sharp and unintelligent competition a few low cost producers in an industry commonly get so much business that it becomes desirable to expand their production capacity if they are to reap the full benefits of their progressiveness.

But so long as there are enough modern plants in an industry, it is evidently poor policy for a concern to build additional ones. A saner and far quicker way to expand is to buy existing plants rather than to build new ones, provided, of course, that the plants acquired are well located and can be secured at a reasonable price. Many of the recent industrial mergers have been for the purpose of securing additional capacity ready made.

Much the same idea is at the bottom of many mergers of chain store systems. Rather than go to the expense and endure the delay of opening brand new stores in a desirable territory and incidentally plunging into competition with an established chain

store, it is better policy, usually, to buy out or merge with the existing chain.

More complete realization of what business is all about, together with increasingly sharp and strenuous competition, has stimulated the formation of vertical mergers, in some cases reaching from the raw materials clear through to the point where the finished product is put into the hands of the ultimate consumer.

In the early stages of industry, when capital was more or less limited, it was the practice for a manufacturer to limit his activities rather closely to the transformation of a raw or semi-finished product into its next form. Thus, there were concerns which spun raw cotton into yarn, others which wove the yarn into cloth and still others which converted the "gray goods" into finished fabrics. The same restricted specialization existed in many other fields.

Lately, it has been realized that the producer of a semi-finished product is bound to be in a difficult position. His goods pass through so many other hands that they seldom are identified by the ultimate consumer as the product of any particular mill. Such products are textiles, leather, pig iron and many others.

It is the hard lot of producers of semi-finished products to be in sharp competition with a host of similar producers. Consequently, selling is largely a matter of price and the profit is apt to be low.

It is coming to be realized that the sole reason for business is to provide the ultimate consumer with something he can use. The consumer is the

all-important factor. It is his loyalty to a finished product that creates that most valuable asset—good will. The buyer of a shirt, for instance, has a certain amount of good will toward the retailer who sold him the shirt, provided it is a good shirt. If the make of the shirt is advertised by the manufacturer the consumer may have good will toward him but he has little or none for the producer of the finished fabric from which the shirt is made, and still less for the producer of the original yarn from which the cloth was woven.

Therefore, on the face of it, it is apparent that so long as a manufacturer produces semi-finished materials for other concerns to process, the cards are stacked against him.

The nearer he can come to the almighty ultimate consumer, the more intelligently he can merchandise his product and the safer and more stable his profits are apt to be.

So sound is the present trend toward vertical integration that some authorities believe the time is not far off when semi-finished materials will have disappeared from the market and when every producer will be a unit in a merger producing finished goods from raw materials. That may likely be the ultimate development, but at present the best thought seems to be that complete vertical integration is not yet feasible for all concerns in all industries.

Yet there is no doubt but that for many concerns vertical mergers provide a way out of current competitive troubles by assuring an outlet for goods

without the necessity of fighting for sales at great expense.

Also, some of the large mergers of retailers are becoming aware of the desirability of uniting with producers so that they may be certain of adequate supplies of the right kind of goods at reasonable prices. This results in mergers between producers and retailers—a trend which will undoubtedly become more marked with the development of large chains of retail stores. Cotton mills, and tanneries, for example, may end up as part of an economic family comprising not only many stores, but factories making shoes, clothing, furniture and a multitude of other products equally diverse.

The increase in the size of various business enterprises, whether by merger or by natural growth, has itself stimulated the formation of still more mergers.

In many industries the small concern is at a hopeless disadvantage in trying to compete with the large one. Sometimes the big business can achieve economies impossible to the small one, and so be able to undersell it. Again, the big company can advertise on a scale which gives it an advantage. Also, in many lines survival depends upon the ability to carry on extensive and expensive research—a luxury beyond the small concern.

It is beyond question that any industry is better off when there are a few strong and well-managed concerns in the field than when several hundred, many of them small, poorly managed or downright irresponsible, are engaged in a battle royal. Competition between big businesses is less likely to be

ignorant or malicious, and while it is apt to be strong, there is a good chance for each, if it is well managed, to get sufficient of the business to provide a fair profit.

It is not alone competition that forces concerns in many industries to become big by the merger route if they are to continue in business.

In some instances producers have found it necessary to combine in order to cope with the concentrated buying power of merged customers. The trend toward huge chains of retail stores has put the small factory in a most disadvantageous position. Strength on one side can often be successfully met only with strength on the other.

It is often said categorically that we are in an era of big business and that every business must become big if it hopes to survive.

On the other hand, it is contended occasionally that big business is so inflexible, slow to move and unwieldy that it is bound to succumb to its more active small competitors as did gigantic prehistoric animals like the dinosaur.

It must be evident that there are trades in which smallness is an asset—at present, perhaps, even a necessity. Such are those in which a high degree of craftsmanship is required. We shall probably, for instance, never see billion dollar mergers of custom tailors. Yet even that statement may well prove incorrect as time goes on. The partisans of small business have reiterated that chains of stores could never displace the small independent merchant, basing their statements upon the alleged desirability

of close personal contact between the proprietor and his customers. Yet the increase in the number of chain stores goes on. The answer is doubtless to be found in the fact that to the consuming public "business is business." It prefers low prices and standardized good service and quality to the warm handshake and often counterfeit personal interest of those from whom it buys.

It is beyond doubt that there is a best size for each business unit, and that this best size is often small. The trouble with many who base their advocacy of small business upon this demonstrated fact is that they confuse a "business unit" with a "business." They are not at all synonymous. A big business may well be made up of a multitude of individually small units.

The retail units of Woolworth, A. & P., United Cigar Stores and many others are individually very small—yet the parent companies undoubtedly qualify as big businesses. Nor are the various foundries and other plants of the American Radiator & Standard Sanitary Corporation gigantic, yet that company is surely "big business." So it goes. There is no apparent limit to the number of individual units that can be gathered under one management.

It would be possible to work out a "best size" for the units in every industry, but this is hardly the place to do it.

Professor Dewing has worked out a law which states that when the labor cost of a product is small compared to the cost of raw materials and overhead expense, the most profitable unit is large, but that

if labor is the largest item of cost the small unit will be most profitable. That is generally true if he is speaking solely from the production point of view. But production is not all there is to business.

The efficient small production unit, faced with competition from a less efficient large unit, might well find selling so expensive that no profits would remain. In such cases—and there are many of them—a merger for the sake of distribution economies is indicated.

But how about the alleged inflexibility and unwieldiness of the resulting big business which is said to make it unable to adapt its product quickly enough to the modern demand for novelty and frequent style changes?

Those who hold this view point to Henry Ford's recent troubles as proof of their contention. Yet there the trouble seems to have been due not alone to the rigidity of the old Ford production machine but also to the rigidity of Mr. Ford's character and the inflexibility of his will.

There is no reason why a large business or even a mass production factory cannot be flexible enough to meet modern conditions provided the management plans ahead and anticipates by a few months what the public will need.

During the erstwhile nearly universal enthusiasm over the Ford production methods, it was the fashion to equip plants with single purpose machines. Naturally, such equipment did not permit quick changes in product. But today there is a trend back toward more versatile equipment which can be

adapted to various products and perform nearly—in some cases fully—as efficiently as the inflexible single purpose machines.

On the whole, it appears that the belief in some quarters that big business is a passing phenomenon which will fall before the agile attacks of small enterprises is based either on the self-interest of small propagandists or, to some extent, on the human desire to see giants slain by Davids. The parallel between huge mergers and the extinct dinosaur fails when it is realized that the dinosaur was notable not only for its great bodily size, but for the extraordinary smallness of its brain. Our successful business giants are directed by large and exceedingly active brains—which are not only skilled in the day-to-day management of a big business, but are fully aware of economic trends and realize the need of keeping their enterprises in harmony with those trends.

It would be possible to list hundreds of direct reasons for forming mergers of one kind or another. The sound ones all boil down to the one basic reason that economies of one kind or another will result from the unified operations.

Many of the early mergers failed because they ignored that reason, and were put together principally for the sake of giving some group a stock-jobbing profit. That is not to say, however, that the chief reason for merging may not legitimately be largely financial.

For instance, it frequently occurs that the owners of a small but prosperous business wish to sell out

or to raise more capital but find that the company is too small to interest investment bankers. The owners forthwith look around for one or more other concerns with which they can merge and so become large enough to be attractive to the bankers. Otherwise they would have to pay too dearly for outside capital.

That is a perfectly proper reason for merging, for economy in financing is as desirable as any other economy. Usually, however, the banker would insist that operating economies result so that the earnings of the merger would be greater than the combined earnings of the merged companies when they were operating as individuals.

As this is written, there is what amounts to a stampede of cotton manufacturers to merge, chiefly for financial reasons. That industry has been told, quite correctly, that hope for its prosperity lies in the formation of sound mergers which will effect economies.

But possible savings seem not to interest most of the would-be mergees. What they want, rather, is to sell out and then get out of the business. Needless to say such propositions are not attractive to bankers.

Some horizontal mergers achieve notable economies by making possible a rearrangement of an industry geographically for the sake of reducing the high cost of long hauls and cross freights. This is particularly true of products which cost little but weigh much. Thus the original American Radiator Company, by merging a number of foundries located

in different sections of the country, was able to make a considerable part of its product close to where it was to be used. At the same time it could reach a national market, which it could hardly have done if it had had to ship its heavy product from a single plant, even though that plant were centrally located.

Sometimes a horizontal merger enables each factory to specialize on a single product although as competitors each had made several, with resulting economies in production.

Again, a good and sufficient reason for merging may be simply that the individual companies each covet the possessions of the others. It may be that one covets another's trade secrets while that one in turn covets the other's sales manager. It is probable that such a combination would make economies possible.

Mutual coveting of patents sometimes results in a highly profitable merger. There was, for instance, the case of two competing manufacturers of automobile curtains, neither of which could operate to advantage because each lacked a patent which the other owned. One had a patent on an improved curtain. The other controlled a patent on an improved device for holding the curtain. An industrial marriage resulted which must certainly have been planned in heaven.

The desire to reduce selling costs has brought into existence a new type of merger, sometimes called "circular." Circular mergers comprise non-competing companies whose products are marketed through the same trade channels. The General Foods Cor-

poration, an excellent example of the circular merger, is a combination of several old companies which between them make some eighty products all of which are sold by grocers.

The merger of the American Radiator Company and the Standard Sanitary Manufacturing Company is another instance of this trend. The products of both companies are sold by plumbers and are often specified by architects.

Sometimes the salesman for a circular merger can sell the complete line. Often it is possible for warehouses to be combined with resulting economies in handling charges.

Some of the most successful mergers combine the horizontal, vertical and circular types—thus securing the economies and other advantages peculiar to each. The United States Steel Corporation is of that sort. So are many of the mergers in the food industry such as baking and dairy products companies. The progressive increase in the ratio of net earnings to sales of some of these well-managed companies is proof of their economic soundness, for the higher ratios reflect not higher prices but reduced costs.

At the moment it is the fashion in some circles to decry the whole movement as unsound and as offering nothing of value to the individual business. Commonly these critics refer to Professor Dewing's scholarly analysis and history of the early trusts, many of which failed to make profits as large as the constituent companies had made individually, and some of which went through repeated financial re-

organizations which were disastrous to the holders of their securities. Also, they point out that some of the modern mergers do not, from the start, realize the prophesied increase in profits.

The trouble is that the critics cite the indubitable fact that many of the old-time mergers failed miserably, but they blithely pass over the reasons for their failure which Professor Dewing emphasizes, namely, that many of them were unsoundly conceived, most of them overcapitalized and loaded with unduly heavy interest charges, and that some of them were grossly mismanaged by wholly incompetent executives.

Thousands of individual businesses, large and small, fail every year for identical reasons. If there really were some magic quality in mergers that assured their success, it might be possible for them to succeed in spite of poor management, but there being no such magic, capable management is as essential to a merger as to a corner grocery or a local brick yard.

It is true that many ultimately successful mergers go through a "hell period" sometimes lasting a year or two or three, during which earnings may fall below the former earnings of the combined companies.

There are many reasons why this is so. Sometimes the customers have at first a prejudice against "trusts" and take their patronage elsewhere until they learn that the modern octopus has no intention of exploiting them. Again, the independents remaining in the field sometimes go gunning for the

merger and precipitate a cutthroat price war which is disastrous, or at least damaging, to all concerned.

Or there may be a falling off in the morale of the employees of the merger, who fear quite naturally, and often rightly, that some of them will be dispensed with. When the inevitable changes in personnel have once been effected this trouble passes.

But probably the most common and most important reason for the "hell period" has to do with the difficulty which erstwhile individual owners have in adjusting themselves to each other and to the idea of team play.

It is but natural that there should be jealousies and maladjustments. A former boss of his own business seldom takes cheerfully to becoming a subordinate executive. Each and every one of them is likely to feel that he should be boss, yet evidently that cannot be.

There are various and usually conflicting ideas as to policies and methods, which result in lost motion, deadlocks and waste.

These conditions are usually most serious in horizontal mergers and least so in vertical ones. In the horizontal type, former competitors are brought together. They are at best suspicious of each other; at the worst, if the competition has been keen in the past, they may cordially hate each other. To make a happy business family of such an aggregation takes plenty of time.

In a vertical merger, the old owners have been accustomed to do business with each other as buyers and sellers. They have learned to compromise their

differences and to meet on a common ground of mutual profit. While there likely will be some clash of personal interests and ambitions, their past experiences with one another make it probable that their differences will be ironed out quite quickly to the best interest of the group as a whole.

Conflict of interests is also often the reason why a desirable merger fails to be consummated or, if it does come into being, is unsoundly put together. It is wholly natural for each individual owner to try to secure the best possible price for his business. Sometimes that striving results in a bad financial structure which may more than offset great operating benefits.

For that reason it is often best to have the negotiations carried on by some capable, disinterested outsider who can reconcile differences and set up a merger as it should be at the start.

That is not to say that many sound mergers have not been worked out by the members of the industry itself. Usually, however, when that happens it is a case of a dominant large company being able to buy out smaller ones, or at least being able to offer such advantages that it can dictate terms. Often the large company was itself the result of an earlier merger.

It is seldom best to try at the start to merge a large number of small independent concerns. Usually the best plan is to start slowly, forming one or more small groups which are closely related geographically or otherwise. When these have been operating long enough for things to be going

smoothly, it will be comparatively easy to amalgamate several of the lesser consolidations. Many of our most successful examples of big business—the Steel Corporation as an example—are mergers of mergers.

Whatever plan is used these three all-important facts must never be lost sight of:

1. There is nothing in the mere grouping of business units which insures success.

2. Skillful management is at least as important in a merger as in a small business.

3. If the combination is not in accord with sound economics, it can be counted on to fail.

CHAPTER II

Types of Mergers

THEORISTS, as a rule, facilely classify mergers as of three types—the horizontal, the vertical and the circular. A horizontal merger, they say, is composed of concerns making similar, usually competing, products. A vertical one comprises concerns performing successive operations—the finished product of one being the raw material of the next in line. "Circular" is their description of the merger which is made up of concerns making allied or complementary products. It is usually, but not always, composed of those which sell through the same channels or to the same markets.

It would be nice if mergers could be so easily and accurately classified. Perhaps rules could then be laid down as a guide for the formation of exactly the type of merger needed to meet any situation, and bankers would presumably find it easy to gauge the possibilities of any proposed or existing merger.

The fact is that a negligible proportion of the thousands of mergers now in existence fit neatly any of these definitions. Most mergers are hybrids—especially the large and successful ones. A few, such as General Foods Corporation, are as yet circular mergers of quite simple structure. American Radiator & Standard Sanitary Corporation, while gener-

ally spoken of as a circular merger, is not only that, but is horizontal and vertical as well. The American Radiator Company started as a horizontal merger of competing radiator foundries. Later it integrated vertically to some extent by absorbing blast furnaces and ore mines. The acquiring of concerns making affiliated products which are sold through the same channels came much later. The Glidden Company has had a similar history of development from a simple to a complex form.

The horizontal merger is the simplest and most obvious type. It is the form usually first thought of by distressed business men when profits begin to hit the toboggan. Whatever may be the real reason for a concern being unprofitable—inefficient production, extravagant selling or sheer general incompetence—it is plain human nature to attribute the trouble to the cutthroat practices of competitors. Often, it is true, that is the real reason, brought on usually by a degree of overproduction in the industry.

What is more natural, when competitors finally find themselves at the point of financial exhaustion, than that they should make friends with each other after a fashion and huddle together for mutual protection against the common enemy, bankruptcy? Thus are many horizontal mergers born.

Typical of this on a small scale is the merger of several lumber yards in a large metropolitan district which formerly had been in sharp competition with each other. There was highly uneconomical invasion of each other's territories, involving expensive

sales competition and trucking to distant points—ultimately at the expense of the consumers as well as of the stockholders.

Combined into one company, each unit became in effect a branch warehouse. The competition was eliminated. Each branch served its own logical territory, cross hauls were eliminated, credit losses were greatly reduced and selling expense kept within reason.

Many of the present-day highly successful businesses started as simple horizontal mergers of this sort and added the vertical or circular features later. At present there is an entirely wholesome movement afoot for just such simple mergers of competing mills in the cotton textile industry. It seems likely that to become most effective these mergers will in time consolidate with still others along vertical lines.

There are horizontal mergers, the members of which were never competitors to any great extent. That type partakes of the nature of a chain operation, the units being more or less separated geographically. The usual aim of such a merger is to secure national distribution economically from strategically located points and at the same time to secure the advantages of massed capital and centralized control.

Most retail chains are of this sort. All department store chains are. So are many of the big baking companies and dairy products concerns. Yet it is difficult to find a chain merger which is not complicated more or less by either the vertical or the circular form, or both. Many chain store systems

own factories. A. & P. owns canning factories and packing plants. Montgomery Ward owns many factories as well as retail stores. Most baking companies have plants that turn out cake and biscuits as well as bread. Some of them, like National Biscuit, are integrated vertically by ownership of flour mills, and others even own a number of retail outlets. Purity Bakeries with its ownership of the Cushman stores is an instance of this.

National Biscuit Company is an excellent example of the combined horizontal, vertical and circular merger. It operates 38 biscuit plants in the United States as well as 19 plants making bread and hand cakes. It is thus in a strong position in all branches of the baking industry. In 1928 it acquired the Shredded Wheat Company and so became still more markedly a merger of the circular type. Ownership of a paper carton factory and of flour mills gives it control of a large part of its raw material requirements.

It is notable that of the early mergers, those that are most successful after twenty-five years or more are those which partake of the vertical form—usually combined with the horizontal. The United States Steel Corporation is an outstanding example.

It produces steel in most, if not all, of its possible forms. A large part of its product is, of course, sold to other manufacturers for further processing yet some of its output is carried through from the ore to the finished product. For instance, the American Bridge Company, a subsidiary, fabricates steel shapes into bridges and skyscraper skeletons. The

American Steel and Wire Company turns into wire and cable the wire rods produced by other steel corporation subsidiaries.

While the Steel Corporation is not completely integrated in all respects clear through to the consumer, it has carried the process of integration backward as far as it can possibly go—namely, to the ore, the coal and the limestone in the ground.

There is a number of real advantages enjoyed by a vertical merger—and some which, under certain conditions, are more apparent than real.

1. Depending upon the extent to which vertical integration exists, each unit in a merger has more or less control over the supply of its raw materials and over its market. Thus there is the seeming paradox that by giving up its independence and joining a merger an individual concern often secures a greater degree of independence than before. Having a definite control of its raw material sources relieves a concern of the uncertainties of price, delivery and quality that go with open market purchases. It is possible to plan production sure in the knowledge that there will be no shutdowns due to faulty deliveries.

2. Selling effort all along the line, except in the final disposal of the finished product, is eliminated. This means that selling expense, buying expense, credit expense and a large part of the clerical expense is eliminated. In some instances the toll taken by these items from the final selling price can be reduced as much as 80 or 90 per cent.

3. To be a link in a vertical merger is particularly

advantageous for a producer of a semi-finished material especially when the raw material is subject to sudden price changes and when raw material cost is a large part of the total cost.

Much of the trouble with the cotton and leather industries is the result of this condition. So large a part of the cost of tanned leather and of cotton cloth is material cost that minor fluctuations in the price of cotton or hides may make the difference between a profit and a loss.

Furthermore, when cotton mills and tanneries become part of a vertical merger the other units of which perform still further manufacturing operations the original raw material cost becomes a smaller—in some cases an almost negligible—percentage of the final cost. Price fluctuations are then of less moment. The large part of the cost becomes labor and overhead—elements of cost which are to a large extent under the control of the manufacturer, while material cost is not.

4. Ownership of plants making semi-finished products enables those products to be made more economically. If a plant turns out a variety of products to meet the specifications and needs of many different customers, its costs will reflect the lost time of men and equipment caused by changing at frequent intervals from one variety or style of product to another. If such a plant is part of a vertical merger, it is no longer governed by the vagaries of demand but can concentrate production on the particular product which the next factory in line uses.

Commonly that simplification of output results in notable production economies.

So real are these advantages of vertical combination that it might seem that complete vertical integration from the production of the crudest raw material to the finished product or even to the retail counter would be the ideal set-up for any business. In many instances, it is highly desirable; in fact, for some industries it is essential to success. But to adopt a policy of complete vertical integration without allowing for special conditions and peculiarities is as unwise as to adopt uncritically any business policy just because it seems to have worked well elsewhere or appears to be theoretically desirable.

For a long time Ford appears to have worked toward complete integration although he never quite achieved it. Lately it appears that he has decided it is best not to make everything that he uses—that in some respects he can do better by buying some parts of his car from outside manufacturers.

At the bottom of this changed policy, no doubt, are several reasons.

For one thing, an automobile manufacturer can seldom make all of the required complicated appliances as well or as economically as can a shop which specializes on one of them—nor is it often possible to get a hired superintendent to do as effective a job as will be done by the owner of a factory that is hungry for orders.

Lastly, but highly important, there is always a possible danger that the management of a factory

which is not under the necessity of competing for business will not be as alert to maintain its efficiency and improve its methods as one which must compete for the business.

Many mergers which could readily produce all of the materials they use thus prefer to buy part of their requirements from outside. This is especially true when the raw material is subject to price fluctuations.

Thus, an oilcloth manufacturing establishment owns cotton mills capable of supplying it with only about 60 per cent of its cotton cloth, although it could doubtless pick up at bargains enough others to furnish its entire requirements. It prefers to go into the open market for part of its cotton goods, which, because of the highly competitive and more or less disorganized condition of the cotton industry, is probably wise as many mills are apparently chronically willing to sell cloth at a loss. At the same time, by ownership of some mills it is assured of a part of its supply under any conditions.

In the same way several shoe manufacturers own tanneries although it appears that none own sufficient tanning capacity to supply all of their needs, and while some baking mergers own flour mills it is probable that all buy some of their flour outside. When operating at capacity the American Brass Company, which is owned by Anaconda, is said to use copper and brass in excess of the total production capacity of Anaconda's mines.

This policy seems to be particularly desirable when the raw material is a staple semi-finished

material, for such materials are subject to occasional overproduction and can often be purchased at less than cost. That, as we have seen, is one of the important reasons which make it highly desirable for the producers of such raw materials to enter vertical mergers.

On the other hand, it is sometimes advantageous for the merger to have overcapacity in some of the preliminary or intermediate units. That has been found to be an effective way to combat the tendency of an owned supplier to let down and fall into inefficient and unprogressive methods secure in the knowledge that it has an assured outlet for its product. If it must go into the open market to dispose of a part of its production, it finds itself in competition and must keep on its toes if it is to get its share of the business. That is of advantage to the merger.

The Knox Hat Company finds it advantageous to combine both policies. Its plants could doubtless produce all of the hats its owned stores can sell, yet the stores buy some of their hats from other companies while the factory at the same time sells hats to other stores. Thus both branches of the business are kept up to scratch.

How far in either direction it pays to integrate vertically depends upon the nature of the industry. Broadly, it may be said that if the ultimate raw material is taken from the ground, as ore, coal or oil, it pays to go back to the original source. Thus we find the Steel Corporation, Anaconda Copper and many others owning their raw material sources.

This is true also of many mergers which use wood as an important raw material. Many paper mills, furniture factories and so on own timber lands, logging camps and saw mills.

Generally speaking, it is considered unwise for a manufacturer to undertake the operation of farms for the production of his raw material. The obvious objections are, first, that a crop failure in the district may cause heavy losses both directly and indirectly through interruptions to production and, second, that farming operations as a rule do not promise sufficient profit to interest industrial capital.

Few, if any, concerns whose raw materials are cereals operate farms. Nor do cotton manufacturers. Woolen manufacturers do not own sheep ranches. On the other hand, some large canners of vegetables, such as the Campbell Soup Company, are also farm operators. That suggests that, if there is a well-organized exchange on which agricultural products are actively traded in, the manufacturer usually finds it best to buy his requirements on the open market.

That theory holds quite well for all except sugar, for we find that the beet sugar companies often operate farms adjacent to their plants, and the American Sugar Refining Company raises sugar cane in spite of the fact that there is a sugar exchange.

How far to integrate in the other direction is also a problem worthy of more careful analysis than it sometimes gets. It is unfortunately not unusual for mergers to become so enthusiastic over the idea of

vertical integration that they go too far in both directions.

The answer to the question, "How far, theoretically, should this merger integrate in the direction of the ultimate consumer?" is often determined by who the ultimate consumer is as well as by what the product is.

Thus, if the product is one which is bought at retail for personal use, such as food, tobacco, clothing, furniture and so on, it may be desirable for the factory to become part of a merger made up of retail stores and perhaps other factories. This often happens. The recently announced merger of which the United Cigar Stores are a part is an instance. That this procedure has wide application to comparatively small businesses and holds much promise for them is shown by the recent development of Knox Hat Company.

This company, primarily a hat manufacturer, has operated a few of its own retail stores for a long time. As a result of that successful venture, it recently acquired the already existing chain of Long hat stores. Foreseeing that under present high rent conditions hats alone would not provide sufficient volume for a retail store, the Long stores were converted into full-fledged haberdasheries and are being run successfully. Thus is disproved the statement often made by certain prominent merchants that common ownership of retail stores and manufacturing plants was basically unsound because no man could be both a skillful manufacturer and a capable retailer.

It is probable that this absurd idea has hampered the formation of many manufacturer-retailer mergers which would have been effective and profitable. It is, of course, obvious that usually the functions will be under separate immediate management with only a centralized control. However, there is an increasing trend to the merging of retailers, manufacturers and sometimes wholesalers. This is wholly sound and will beyond doubt be more generally done.

When the product is one which has many uses and enters into many products it is usually advisable to stop the integration somewhat short of the ultimate consumer.

Anaconda Copper Mining Company found it desirable to merge with the American Brass Company, itself a merger of nine companies which produce finished brass products, in order to protect its business by controlling the outlets for its metal and to promote the sale of copper and brass products.

The output of American Brass Company constitutes many thousands of items most of which go finally into other products. It would be manifestly absurd for Anaconda to attempt to own its myriads of customers. To do that, it would have to own thousands of roofers and tinsmiths, railroads and factories turning out everything from brass jewelry to telephones, railroad cars and automobiles.

The so-called circular merger which sells allied products to the same customers is generally thought of as a new development yet it is really but a short cut, on a large scale, to an end striven for and often reached by many individual manufacturers. There

are thousands of examples. The General Foods Corporation, itself the much cited instance of the new circular merger, long before it took part in a merger manufactured as the Postum Company many allied products such as Grape Nuts, Postum coffee substitute and Post Toasties.

Doubtless it could in time have developed a brand of coffee, of maple syrup and various other grocery products and marketed them through its established organization, but it would then have experienced severe competition from established brands like Maxwell House Coffee and Log Cabin Syrup. The sensible thing, obviously, was to merge with those existing, intrenched companies.

The Fleischmann-Royal Baking Powder merger, according to a recent statement attributed to the president of the new Standard Brands, Inc., was primarily for the purpose of more fully utilizing the extensive and intensive distribution system built up by Fleischmann. Its delivery system covers 13,000 towns by direct delivery and 35,000 towns by one-day package delivery and serves 30,000 bakers and from 275,000 to 300,000 grocers. The advantage of using such a highly developed and comprehensive system for distributing other grocery products in addition to those made by the Fleischmann Company is apparent.

Another circular merger demonstrating the possibilities open to comparatively small concerns is the Houdaille-Hershey Corporation in the automobile accessory industry. This is a merger of four manufacturers, one of whom made automobile bumpers,

one who made Houdaille shock absorbers, another a device for coincidentally locking the steering column and the ignition, while the fourth company makes a varied line of equipment such as motor cooling fans, tire locks, tire carriers and miscellaneous automobile hardware.

None of these products compete with any other products made by the merger. All products are sold to the same market—automobile manufacturers—and so a contract for one device tends to create a demand for other items. This is a powerful factor in selling.

Any concern which, like the individual units in the Houdaille-Hershey merger, sells to a few large users is faced with the possibility that failure to renew a single contract may affect net profits seriously. No one of the individual divisions sold to more than 13 customers, but, as this is written, the merger as a whole sells to 30 of the leading American motor car builders.

The consolidation is thus much better intrenched and enjoys a much greater stability than did any of its units independently. It has not only a great diversification of product which eliminates the possibility of a change in style or a new fad affecting it seriously, but the diversification of customers is equally a safeguard.

Circular mergers generally comprise units whose products are closely allied from the selling angle. There are, however, a few examples of concerns whose various products are sold to different markets and through different channels. Superficially, it is

sometimes hard to see what justification there can be for such mergers, but the successful ones are found, on examination, to be perfectly logical.

For instance, there is at first glance little apparent reason why the Glidden Company, primarily a manufacturer of paints and varnishes, should become a producer of margarine, salad dressings, meat sauces, shredded coconut and other food products.

Originally, the Glidden Company was a horizontal merger of several more or less competing paint and varnish manufacturers. Later it bought zinc and lead mines in order to have an assured source of supply for some of its principal raw materials. Still later it opened a number of wholesale and retail outlets. It thus is to some extent integrated from the ore in the ground to the ultimate consumer.

Several years ago when it bought out a paint company it was forced also to buy a small margarine producer. Margarine is sold on a much narrower margin of gross profit than paint and its turnover is much more rapid. In these characteristics, in fact, margarine is almost diametrically opposed to paint and varnish.

After operating the margarine property for a while the management decided that the two sets of characteristics as to margin and turnover provided a desirable stabilizing combination. Furthermore, the Glidden Company's research department was already familiar with vegetable oils, and margarine is made from coco oil. The next step was to integrate this branch of the business by buying a concern which produces coco oil from the dried coconut. It

was also logical to buy a producer of shredded coconut.

So successful was the company's experience in the food products industry that it felt it was not going too far afield by acquiring E. R. Durkee & Company which manufactures salad dressings, meat sauces and allied products.

Here there seems to be a basically sound reason for merging seemingly unrelated businesses. According to a statement of the management, the reason is to enable the company to assume "more and more the character of a great chemical organization, utilizing its laboratories and technical research facilities in the logical development of a diversified line of products."

This circular type of merger, whether it has its inception in products allied in a selling way, or because there is mere basic similarity of raw material or processing, or to secure a desirable balance or diversification, seems to be increasingly promising. Certainly it is economically sound especially when, as with the Glidden Company, it combines the circular with the horizontal and vertical types of integration.

CHAPTER III

Production Economies of Mergers

CRITICISM of mergers during the old "trust busting" period was chiefly on the ground that their purpose was to exploit the consumer. It emanated largely from independents who found themselves pushed to the wall as well as from self-appointed friends of the people who saw in the feared exploitation of the masses a hook on which to hang their political aspirations.

Such criticism is understandable. It is less easy to find the motive which actuates those who so loudly and persistently decry the present merger movement on the ground that consolidations seldom succeed in effecting the operating economies which their sponsors prophesy. The business press is full of such statements—not, however, usually sponsored by men who are recognized authorities nor supported by convincing facts. Some of these criticisms apparently are the efforts of men who hope to achieve a measure of personal publicity by the somewhat hopeless method of opposing a strong trend. On the other hand, not a little of it seems to come from owners or executives of small concerns who fear that if merged they might find themselves out of jobs.

Those who say that the promised production economies from merging fail to materialize seldom

cite modern examples, but rather hark back to those trusts formed during the nineties which were not notably successful.

It is true that the promoters seldom stressed the real reason underlying those early consolidations, namely, monopoly which would enable them to raise prices. Rather they catered to public opinion by referring in broad generalities to the economies of large scale production. Taylor was then quite well along on his experiments which ultimately gave rise to scientific management, and his achievements were attracting considerable public attention and interest. Naturally enough, promoters tried to cash in on the public interest in the new theories of mass production. But there was then actually little known about scientific mass production and still less was it practiced, even by the large consolidations. More real attention was given to the financial side of mergers than to production and distribution.

Today it is different. A vast fund of information on production methods is available. There is a real science of management, and scientific production is the rule rather than the exception. It is also true as a rule that the new low cost methods can be utilized to the utmost only by the large rich companies —and that usually means, by mergers.

So, while it is entirely possible to cite occasional modern mergers which for one reason or another have not as yet been notably more successful than were their constituent companies, it is not at all easy to dig up one which has not bettered its production procedure and lowered its production costs.

When mergers fail or experience hard going the critics commonly attribute their trouble to inability to achieve economies. More often the cause is not that at all. For instance, I recall offhand two mergers in two different industries which have effected considerable savings in production costs but which are not yet profitable. The formation of one precipitated an ill-advised and pugnaciously prosecuted price war by the merger's independent competitors—which incidentally has been more disastrous to the independents than to the "trust" because of the latter's lower costs. The other is in an industry whose sales have fallen off sharply due to a change in public taste which adversely affects the sale of its products. These catastrophes, it should be noted, have overcome the independent companies as well as the mergers.

In many instances a merger succeeds in notably reducing all three elements of production cost—direct labor cost, material cost and overhead expense. Most mergers are able to reduce the latter two. But when the product must be made by hand work—and especially if it requires a high degree of craftsmanship—there may be little advantage on the side of the large company so far as direct labor cost is concerned. In fact, in specific cases, close personal supervision by the owners may secure greater production per man than is ordinarily secured for the same kind of work in the large, impersonal plant. Certain recent studies show this to be true in isolated cases.

But if the product be one that can be made by

mass production the advantage is all with the big company. For one thing, the small company's sales are usually insufficient to enable it to get on a mass production basis. Then too, in many industries machines are available which, though expensive in first cost, are economical as producers. The merger, with greater resources, can afford them while the smaller concerns must be content with less efficient equipment. Furthermore the big company, paradoxically, is more likely to pay attention to little inefficiencies in the use of labor than is the small company.

Material cost is nearly always lower for the larger company due to its greater purchasing power, its relatively smaller inventories, more efficient handling and less wasteful utilization of materials. If the management of a merger is alert and careful it can usually achieve a lower overhead cost per unit of output due to the fact that there is greater production over which to spread the total overhead.

Hence, while it may be true that not all mergers are more efficient as producers than were their formerly independent units, when it occurs that is due to faulty management rather than to any inherent weakness of mergers. Even those circular mergers whose primary purpose is to effect distribution economies usually find it possible to reduce to some extent their production costs.

In order to secure production economies it is not necessary that a merger be of gigantic stature. Some highly efficient ones are by modern standards not at all in the category of "big business." They consti-

tute the vast majority of moderately large mergers that nearly any small or medium-sized business is apt sooner or later to have an opportunity to join.

The principal advantages production-wise that mergers of any size have over small or even fairly sizable independent manufacturers are:

1. The substitution of skilled management for unskilled.
2. Financial strength which makes possible heavy investment in expensive labor saving machinery and research into factory methods.
3. Concentration of production of one or a few similar items in individual plants.
4. Comparison of operational results of several plants producing similar products.
5. Selecting the best methods used in any unit as the standard for all.
6. The merging of the best brains brought to the merger by the units.
7. Reduced material costs from greater purchasing power.
8. In the vertical merger, greater stability of production due to ability to plan production in the light of a known and assured demand.
9. The ability to reduce the number of varieties of product produced.

It is to be noted that in this chapter the discussion is confined strictly to economies in production costs, and no reference is made to the great savings in general, administrative and selling expenses which are usually achieved by skillfully managed mergers. The ways of reducing selling costs are discussed in

Chapter IV—The Distribution Economies of Mergers—while the actual achievements of mergers in reducing general and administrative expense are set forth in Chapter V.

Of course, there is no reason why a small concern cannot be quite efficient in many respects. Some are; but a great many are not. This is most often the case when it is a closely held family concern, paying enough in salaries and profits to satisfy the family needs. This is commonly due both to a rigid adherence to traditional methods, usually inefficient, and to lack of incentive to better the methods. Self-satisfaction is easy to achieve and hard to overcome.

When such a concern is sold to a merger the new management can generally be relied upon to make a thorough housecleaning and put modern production methods into effect.

An example is that of a well-managed and hence highly successful merger which bought a concern operating four small factories in different parts of the country. A family concern, it had for many years provided jobs for the cousins and in-laws and, in addition to their salaries, had given them profits of about $400,000 a year—which satisfied the owners. Being satisfied, they had been oblivious to the gross inefficiencies they tolerated and apparently had no conception of what scientific management in its various ramifications could have accomplished for them.

The merger's production experts found that all four of the newly acquired plants were most inefficiently operated. Three of them were forthwith

shut down and all of the production concentrated in the best located one. By installing modern production methods this one plant, which itself originally employed about 250 workers, now turns out the same production as did the four—and does it with only about 150 employees.

Chiefly as a result of these economies and with practically no change in the volume of business, the net profits of this recent acquisition have trebled since it went into the merger. Grant that the same results could have been accomplished without the help of the merger, the fact remains that they were not. This is a common case.

It would be all but impossible to overstate the tremendous possibilities of this sort which exist throughout industry among small unmerged family-owned businesses. The owners feel no duty to anyone to improve methods to the end that profits may be increased. The managers of a merger, on the other hand, in spite of the fact that they may hold stock in it, are essentially hired men and as such are subject to being fired if they do not produce adequate profits. They usually recognize this duty to the large number of non-active stockholders and so exert every effort to search out sore spots in production and apply effective remedies. If they do not, they are the objects of censure by the board of directors and the bankers—and it is to be remembered that the modern banker, commercial or investment, is likely to know more about production than did the factory superintendent of even a few decades back.

Again, a merger can usually afford to employ on full time high-priced experts as regular staff members, whereas the smaller units as independents could employ them only occasionally on a part-time basis, if at all. By periodical visits to the various branches and by standardizing on the best methods these small plants get the benefits of the best brains at a cost which is less than it would be for even ordinary part-time consultation.

It is usual for mergers to maintain more or less elaborate statistical organizations for the purpose of comparing detailed operation costs. In fact, the presidents of several successful mergers stress the value of such comparative figures in working out and standardizing the best methods.

An example is that of a large merger in the dairy products industry which has devised uniform methods for determining the costs of its various products. In comparing the over-all manufacturing costs of two of its ice cream factories, it was found that the per gallon cost in one was 3 cents less than in the other. The quality of the ice cream made was the same and there was no difference in the price paid for raw materials and labor.

This discrepancy in costs led to a careful scrutiny of the detailed costs in each plant, operation by operation, in the hope that the better methods could be discovered and applied in the other plant, thus reducing its costs 3 cents. Instead the study by capable cost and production men brought to light the following theretofore unsuspected conditions.

Operation Number	*Overage in Costs* Plant A	Plant B
1	$.01	
2		$.02
3	.04	
4		.02
5	.02	
Total Overage	$.07	$.04

That is to say: on operations 1, 3 and 5 Plant A's costs were a total of seven cents per gallon higher than Plant B, and on operations 2 and 4, Plant B's costs were a total of four cents higher than A's. Stated another way, while the low cost plant was more efficient on operations 1, 3 and 5, the high cost plant was the more efficient on operations 2 and 4. Nothing would have shown up this condition but a well-designed modern cost finding system which enabled comparisons to be made between similar plants. Even with such a system it is doubtful if it would have shown up in an individual plant without the opportunity which the merger afforded of making direct comparisons with another plant.

Obviously, this comparison showed the merger how to reduce the costs of both plants, one by seven cents and the other by four cents, merely by standardizing for both plants the lowest cost method used by either. Without comparative figures based on a uniform cost accounting method, the costs of both plants might have remained too high indefinitely.

It is the practice of many mergers to require all production executives to visit all of the company's plants periodically to give and get ideas. Shortly after the consolidation of the American Radiator

Company and the Standard Sanitary Manufacturing Company, the production executives of one of the companies disclosed a method of its own which lowered the other company's production costs about $400,000 a year.

The mere fact that in some types of horizontal mergers several plants are turning out the same product is, with skillful maneuvering, a force for keeping production efficiency at a high level. Even though a plant be equipped with the most efficient machinery and the most effective methods of production, the production executives may not function efficiently. Driving from above is not always effective, but set the managers of several plants to competing with one another on costs and they will probably achieve high standards of performance.

Thus we commonly find the comparative costs of similar plants sent to all of the production executives of a merged group. The usual result is that they all strive for the best record of efficiency.

Standardization of equipment and supplies for all plants gives advantages in buying, keeps inventories lower and makes it possible to transfer surpluses in one plant to another when they are needed.

The mass purchasing power of a merger frequently gives it great savings in its raw materials. One merger saves on an average 10 per cent on the purchase price of such items as containers, labels and numerous factory supplies. A dairy products merger estimates an average saving of 7½ per cent —the smallest being 3 per cent on gasoline and the largest 30 per cent on paper products.

A combination of lumber dealers in one city saves from $2 to $3 a thousand feet on lumber and 3 to 5 per cent on mill work as a result of the concentrated buying power. As independent concerns much of their materials came in less than carload lots. The merger buys in car lots with consequent additional savings in freight.

When it is considered that the purchases of many mergers run well up into the millions of dollars a year it must be evident that the savings due to massed buying power are well worth while.

Yet we find, strangely, that in certain uninformed quarters this very ability to buy in large quantities is considered to be a direct and serious handicap to a merger. Suppliers, so the fairy-tale goes, take advantage of the known needs of the merger to buy large quantities of raw materials by jacking up prices when the merger enters the market. It is frequently said that a small concern, whose needs are more modest, does not tend to bull the market for commodities when it buys and, furthermore, can often cover its needs by taking over odd lots of more or less distressed merchandise.

It is difficult to believe that this is today a serious handicap. It may have been in the early days when mergers tended more toward the horizontal than to the vertical form and so had less complete control over their raw material supplies. Most of the large and successful mergers now either control a large part of their raw material sources or buy from scattered sources. Examples of the first are United States Steel, Anaconda Copper and National Biscuit.

In the second group are chiefly the dairy products companies. For other types of mergers, their ability to pay promptly, the advantage to a supplier of selling such large quantities as to make manufacturing economies possible and the prestige that comes from having large and prominent customers makes it possible for the merger to get low prices on what it needs.

It would be a naively managed merger that today found its large buying power to be a handicap rather than an advantage.

When a number of similar plants are consolidated there is frequently great saving from elimination of excess capacity. Thus, when one medium-sized Western merger acquired three additional companies in its territory, there were 28 plants in operation. Seven plants were shut down and the territory served with 21 at an annual saving of $223,000 in overhead expense. In one year a small merger of a few ice cream factories increased its net profits 15 per cent as a result of the operating economies it, as a merger, was able to effect.

A consolidation of several flour mills also concentrated production at the most efficient and best located plants, thus getting 24-hour operation at a few, rather than 12-hour operation at several, with resultant savings.

A group of fourteen steam laundries recently merged. As competitors not one of them had been able to secure enough business to operate at full capacity. When a bird's-eye view of the consolidated operations uncovered this condition, seven of the

fourteen laundries were shut down and the entire business handled by the balance—in spite of the fact that the business was 20 per cent greater than the total amount done by the fourteen laundries as independents.

A merger of several plants making similar products can often secure a degree of specialization, with resulting production economies, that would be impossible for any one of the plants as an individual. In fact, it is safe to say that this is one of the most prolific sources of economies for horizontal mergers. Thus, a group of furniture factories, each of which made a varied line of products, consolidated both to secure greater financial strength and to effect various economies.

At the start it was determined to have each plant specialize on one type of furniture. Mass production, which formerly was impossible for any of the individual plants, is now the rule in all. One mill makes nothing but chairs, another nothing but frames for upholstered furniture. What is more, the latter makes the frames from the waste material of other mills.

Specialization is possible not only in products but in operations. Operations were specialized with resulting economies when two furniture factories merged.

The workers in one of the plants were craftsmen who did beautiful cabinet work of marvelous workmanship throughout. Putting a fine finish on their products was a labor of love. But they simply could not be pushed to do the rough preliminary construc-

tion with speed and by mass production methods. They insisted on doing even that part of the work much better than there was any need.

The other plant had been on a mass production basis. The employees were not skilled cabinet-makers. All they had been taught, and all they were interested in, was to push a lot of work through in the shortest possible time. Their finishing work was careless and atrociously poor. They sacrificed everything to getting production. But so far as the preliminary rough work was concerned, it was good enough for the purpose.

When these facts came to light, the management concentrated all of the construction of the rough furniture in the mass production shop. The furniture was then shipped to the other plant where nothing but finishing was done. A better product was thus produced by the merger at lower cost.

It is generally agreed by industrial engineers that it seldom pays to mix these two kind of workers in a small factory. The artisans are apt to be spoiled and the mass production workers are not improved.

This was at the bottom of one merger in the hat business. A company which had built a reputation on a fine, high priced hat, wanted to round out its line with a cheaper one. It found that its highly skilled workers simply could not turn out a low priced hat that could be sold at a profit.

So it merged with a company that was organized to make low priced hats in volume, with workers accustomed to speed up their work with less regard to quality. Each unit in the merger concentrated

on what it could do best with resulting benefits from a production standpoint.

Another recent combination put together three companies each of which produced a fairly complete line of valves and pipe fittings, some made of brass, some of cast iron and some of steel. Each plant thus made quite a diversified line. As usual where there is such diversification, costs were too high. When the consolidation went into effect, each plant concentrated on one particular line of product. The result was a saving in production costs that amounted to around $500,000 a year.

A merger of a large number of paper mills also produced specialization with resulting economies. As competitors it had been necessary to shut down the expensive paper machines at frequent intervals in order to change from one type or width of paper to another in accordance with the orders of customers. As a consolidation, each paper machine is so far as possible kept busy on a single style and width of paper. About 90 per cent of the mills now operate continuously with no need to shut down to change the paper. In paper making this is highly important, for a paper machine is expensive and costs a great deal per hour whether the machine is operating or not. The difference between a profit and a loss may depend upon the amount of time it is shut down for changes.

The increased possibility of having factories specialize on products as a result of merging is common to most industries. Thus when three silk mills merged one of the first economies realized came from just this. There is a certain kind of silk which is

practically a standard and staple product of most silk mills. Each of these three mills turned out about 1,000 pieces of it a year. When merged all of this production was centered in one mill. An entire section of the mill was put on continuous production of nothing but this standard item. As a result, with no additional operators or machines the production increased to 3,500 pieces a year—an increase of 16⅔ per cent which is well worth while as a cost reducing step.

When several silk hosiery mills owned by three separate companies consolidated, the savings from a production point of view were still more notable.

Company No. 1 was producing about 850 items of hosiery, counting all styles, sizes and shades; company No. 2 produced about 700 varieties; while No. 3, the smallest, turned out about 450 items. As independents, then, the mills were producing about 2,000 items, all different. One of the first things done was to study the sales of each and to eliminate excess items that were so nearly alike as to serve no useful purpose, but just enough different to raise production costs. As a result some 600 items were eliminated from the line offered by the merged companies. This 30 per cent reduction in varieties notably increased total production and reduced costs.

Analysis of the production of each merged company further showed that 80 per cent of No. 1 company's output was in the $1.95 a pair price class. Fifty per cent of the production of company No. 2 and 40 per cent of company No. 3 was in that price class.

Before the merger each company had been forced

to turn out not only its $1.95 staple hose, but other types as well, in a single mill. After the merger was effected all $1.95 hosiery was switched over to a group of mills well adapted to the purpose. They concentrated on turning out $1.95 hose and nothing else.

These changes, made possible by merging, had four principal results:

1. The production of "seconds" had formerly constituted about 12 per cent of the total production. After the rearrangement of production only 8 per cent of the total production turned out to be seconds.

2. The inventory of the merged companies was about 40 per cent less than for the same companies operating independently. This usually occurs in mergers. As competitors each concern is forced to carry what may be termed competitive inventories—that is, each must stock the same items, especially of slow moving merchandise, as its competitors so as to be able to make prompt shipments. Merged, this duplication of items is needless and the merger can carry smaller amounts in comparison to its sales without the danger of being out of called for goods.

3. The production of the merger increased 7½ per cent over the former total of the merged companies, and this increase came in spite of the fact that the total number of operators was reduced.

4. There was a large reduction in non-pro-

ductive factory and clerical expense due chiefly to the simplification of lines and to the elimination of duplicated clerical effort.

The instances just cited have had to do with horizontal mergers whose constituent companies make similar and competing products.

In vertical mergers the possibilities of reducing production costs are equally notable. Conditions in different industries vary so widely that it would hardly be feasible to attempt to cover all possibilities. We shall cite only two—but they are typical.

In a vertical merger great production economies often result from being able to plan the production of the successive units. When the demands of the market as to quantity and type of product must be guessed at, it is difficult to plan the production to the best possible advantage. But when the immediate market is assured, as in a vertical merger, its requirements can be closely determined. The savings, as any production man knows, are considerable.

That was the chief reason why Knox Hat Company bought the Long Hat Store chain of 49 stores. When its factories were dependent largely upon independent retailers it had difficulty in getting them to place orders far enough ahead to enable production to be planned for most economical manufacturing. The company offered inducements to get the dealers to order ahead and achieved some beneficial results but there was still far too much seasonal fluctuation. In the off season production was only

about 36 per cent of the volume it reached at peak periods.

Now the owned Long stores place their orders for production in the off season with the result that the factories never fall below a production of about 60 per cent of the peak rate with a resulting notable saving in costs. That is typical of one of the advantages, production wise, that come from vertical integration.

Another type of production economy common in vertical mergers is exemplified by a consolidation of a number of hardware manufacturers. The original merger comprised several competing factories making much the same products. Later non-competing concerns making allied products that could be sold through the same trade channels were taken into the merger.

All of these concerns bought forgings for use in their product. They patronized a number of forging producers, but gave much of their business to one shop that turned out a product of excellent quality. Yet for years this concern, in spite of a large and seemingly attractive business, had never made a profit. The trouble was that it was essentially a jobbing shop willing and anxious to make almost anything in the way of forgings that anyone would buy. It was therefore under heavy expense for selling. When it secured an order, it had to make special dies and tools, and, what was worse, was constantly under the necessity of changing its machines over at frequent intervals from one product to another. In the course of a year it would make

literally thousands of different items for nearly as many different customers.

Finally, this forging company was taken over by the hardware consolidation, thus making a combined horizontal, circular and vertical merger. The forging company no longer went afield for orders for all conceivable kinds of forgings but concentrated on producing the comparatively few items used by the other manufacturers in the merger.

The immediate result was an 85 per cent reduction in the number of varieties of product turned out. The ultimate result was that with no increase in price this company, that as an independent had had trouble merely breaking even, was able as a unit in a vertically integrated merger to show profits of about 10 per cent on its net worth—a sum of well over $200,000 a year.

We have not mentioned here the great savings in administrative and clerical expenses which affect production costs, and which as a rule are easily achievable in mergers of the horizontal, vertical or circular type. Nor have we attempted to cite more than a few of the more obvious and yet typical direct production savings that are possible when several concerns merge on a sound economic basis and under skilled management. However, the instances cited should indicate the notable economies in production that can often be achieved when several independent companies pool their resources and correlate their effort under intelligent management.

CHAPTER IV

The Distribution Economies of Mergers

ONE of the few things on which most business men and practical economists are agreed is that distribution is nowhere nearly as efficient or effective as production.

Among the most important reasons for this condition are overproduction, too much stress on volume sales rather than profitable sales, and overshadowing them all and partaking of them all—uneconomic competitive selling.

It is not surprising, therefore, to find that the reduction of distribution expense is often uppermost in the minds of those business men and bankers who are active in bringing about the formation of industrial mergers.

Theoretically, it would seem that every merger, whether horizontal, vertical or circular in form, would offer opportunities for great economies in selling. Practically, however, it is not always possible or if possible it may be unwise, to achieve the full measure of the economies theoretically possible. But the fact remains that most soundly put together and capably managed industrial mergers do succeed to a great degree in reducing distribution costs—considering as distribution costs not only advertis-

ing and selling but the cost of getting the product from the producer to the ultimate consumer.

Consider first the horizontal merger composed of concerns performing the same business function in an industry—whether or not they were formerly in direct competition.

If the products of the merged units are the same it is evident that much direct selling expense can be eliminated by the simple expedient of staging a massacre of the salesmen.

Where, say, twelve representatives of as many merged competitors formerly pestered a single buyer, eleven can as a rule be eliminated, saving not only their salaries and expenses but the buyer's time and disposition as well.

Duplicate selling effort is obviously necessary so long as several competitors are desperately cultivating every account. What this waste amounts to in money no one knows, but it doubtless accounts for a considerable part of the estimated eight billion dollars a year of distribution waste. An inkling of the magnitude of the duplication of salesmen can be gained from the following illuminating figures compiled from a recent survey by the Sherman Corporation, which show the number of calls made by salesmen during a single week.

It is a fair estimate that the bulk of the salesmen representing jobbers and manufacturers of cigars, drugs, furniture, groceries, jewelry, radios and shoes were direct competitors—with considerable competitive duplication in the other classifications. Quite evidently mergers of several concerns in each

NUMBER OF SALESMEN'S CALLS

Retail Classification	*No. of stores Studied*	*Jobber*	*Mfgr.*	*Mission-ary*	*Survey Investi-gator*
Automobile	39	353	466	180	5
Cigars	34	328	180	100	2
Department	43	1,795	2,521	196	20
Drug	113	1,301	1,995	657	56
Electrical	74	940	632	226	8
Furniture	74	543	1,914	445	17
Grocery	108	1,098	861	497	17
Hardware	109	1,417	1,409	640	14
Jewelry	36	296	458	70	5
Men's Furnishings	37	317	730	137	13
Radio	35	375	332	91	11
Shoe	99	499	1,337	215	17
Stationery	38	381	596	85	9
Totals	839	9,643	13,431	3,539	194

line would reduce the number of salesmen needed by the merged companies to one for the group. This has worked out in practice many times.

For example, a medium-sized merger of flour mills found the saving through eliminating duplication of selling effort to be one of the principal benefits resulting from the merger. Furthermore, the president states that because the larger buyers formerly split their orders between several independent mills, none of the mills could afford to spend the time, effort and money to get really close to those accounts. The merger could, and did. As the president says, "The consolidation, because of the larger volume it could expect to get, finds it profitable to spend the time and money necessary to get thor-

oughly acquainted with the big buyers. The result is that we get considerably more business at very much less sales cost."

In another case a well-known company took over a couple of smaller competitors and sold the increased production at remarkably lower cost per dollar of sales—due almost entirely to the fact that it handled the combined sales with its own old sales force.

Even when the merged companies are in direct competition only in parts of their territories, this saving of duplication is notable. This is shown by the results achieved by such semi-chain mergers as exist in the baking and dairy products businesses.

Thus, one of the leading mergers in the baking industry saves 10 per cent as a result of consolidating the routes of its trucks, whose drivers are not only delivery men but salesmen as well. Again, three Western ice cream manufacturers who merged recently were, before consolidating, operating 132 routes. The following summer, after the three had been merged, the same territory was served with 86 trucks—a saving of 46 trucks. These trucks each cost about $500 a month to operate counting all direct expense including gas, oil, tires, depreciation, repairs, salesman-driver and his helper. The monthly saving in distribution expense is thus $23,000 made up of savings both in direct selling and in physical distribution of the product.

Savings in the cost of physical distribution is given by one man who has been active in putting together a large number of mergers as being probably

the most important reason underlying modern mergers of the horizontal type—that is, of concerns making practically the same product. He points out that the present era of mergers started immediately after freight rates began to climb some 14 years ago. When freight did not loom so large in the selling price, the invasion of distant territories was not so expensive, but with high rates, cross hauling amounted to so great an economic waste as to attract attention.

Delivery costs, whether delivery be by rail or truck, stimulate the merging of companies so located that their natural territories overlap and of those which, in the struggle for sales, go far afield from their natural territories. The merger, so far as it confines the deliveries from each plant to the natural territory, eliminates cross hauling along with competitive selling effort. Take as an example the case of a merger of four retail lumber yards in an Eastern city.

Prior to the consolidation 50 per cent or more of the material sold by the yard located on the western edge of the city was hauled across the entire city and delivered four to five miles beyond the northeast yard. At the same time the northeast yard was delivering from 30 to 40 per cent of its orders the same distance beyond the western yard, while the two centrally located yards were hauling from 80 to 90 per cent of their material, either northeast or west beyond the two outlying yards. As a result of cutting out these cross hauls the merger has eliminated all hiring of equipment which formerly

amounted to about 15 per cent of the total delivery cost of the four companies. In addition it has used only 90 per cent of the equipment formerly needed. The delivery charge was cut 10 to 15 per cent the first year and there still remain possibilities which cannot yet be realized but which promise to make the total saving 25 per cent.

The merger of some 60 wholesale drug houses by McKesson & Robbins, Inc. promises to result in marked savings of distributing expense, among other things. As only those wholesalers who are well located are taken in, there is some opportunity to reduce delivery expense where there was uneconomic selling at considerable distance from home. Also, all invasion by salesmen of the territory of neighboring jobbers who are in the merger has been eliminated. Thus, there will doubtless be savings in cross freights, in salesmen's salaries and in sales management.

The high cost of delivering goods to the market is also an influence tending to merge widely scattered plants, even though they be too far apart to compete. This is especially true when one concern has either a well-known product or has so good a product that it seems likely a national demand can be built up for it. By making such a product at several strategically located plants the freight rates are greatly reduced and sales increased. This is of fundamental importance to companies like the American Radiator & Standard Sanitary Corporation many of whose products are so heavy and bulky in comparison to their prices that the radius through

which they can be shipped is quite rigidly limited. For such products national distribution would be practically impossible without a number of plants located close to the various markets.

There are in some cases great opportunities for a horizontal merger to reduce its advertising expenditures materially below what was formerly spent by the competing units. It is undoubtedly that fact which accounts for the strong anti-merger propaganda which seems to emanate from some members of the advertising fraternity. They quite rightly are apprehensive of a movement which seriously threatens their incomes.

A considerable part of the money spent for advertising is competitive. Certainly this waste can be reduced as competition is reduced through mergers. Yet in many lines it would probably be unwise to reduce the advertising expenditure in exact proportion to the reduction in competition. In many instances part of the appropriation could well be transferred from competitive advertising to educational. As some observer has pointed out, there is today a great waste in 75 or 100 brands of toothpaste fighting each other with high priced advertising space, extolling the merits of Jones' Paste over Smith's Paste when they might better combine a part of their present advertising expenditures and make new users of tooth paste out of the possibly 80 per cent of the population who at present use none at all. That condition exists in many branches of industry. Combined advertising for educational and promotional purposes, instead of individual

advertising for narrowly selfish competitive ends, offers great opportunities for horizontal mergers to lower selling costs both by reducing the advertising expense and by increasing the volume of sales.

Incidentally, the present tendency of concerns in totally different industries to merge in circular groups may well have the same effect by reducing the so-called super-competition between industries for the consumer's dollar. As this is written comes the announcement of a merger of a retail store chain, tobacco companies and a candy manufacturer. Had Lucky Strike been thus allied with an important manufacturer of candies, it would hardly have attacked the sweets industry at such heavy advertising cost. And naturally the candy and sugar industries would then not have felt themselves forced to retaliate in self-defense.

In simple vertical mergers, too, there are possibilities of reducing selling costs. The more completely such a merger is integrated the less necessity is there for any unit to exert selling effort to dispose of its product. If all of its product is used by the unit next in the production stream no selling effort is needed. If a part of its output must be sold outside some selling expense is, of course, necessary. The elimination of all selling and buying expense and a large part of the accounting involved in intercompany sales makes a great saving. When we achieve the ultimate economic goal of taking out of the market all raw and semi-finished materials, business and the ultimate consumer will be relieved of a burden occasioned by intercompany selling

amounting to hundreds of millions—perhaps billions—of dollars a year.

Vertical mergers commonly enjoy a further advantage that can be made to reduce the cost of selling the ultimate product to the consumer. By eliminating intercompany selling expense, by reducing or eliminating the profits on intercompany transactions and by reducing production and administrative costs, the vertical merger can sell at lower prices than its non-merger competitors. When all is said and done there is no selling argument quite so persuasive as low price, quality considered. That is today generally admitted. It is surprising to see how generally true it is that high priced goods cost more to sell than low priced competitive products.

The completely integrated merger in any field has thus an all but insurmountable advantage over its unintegrated competitors. That this is becoming generally understood is shown by the fact that when one vertical merger gets well under way in an industry, competitors frequently hasten to form other vertical mergers in self-defense.

Moreover, most vertical mergers partake also of the horizontal in form. That is to say, in one or more, sometimes in all, of the stages between raw materials and the consumer, there are several units all performing the same functions. Therefore, most so-called vertical mergers are able to achieve not only the economies inherent in the vertical form, but those possible to the horizontal as well.

So much for the distribution economies which can

be secured by the two older forms of mergers—the horizontal and the vertical.

Recent years have brought about the development of an entirely new type, the circular, whose basic and principal purpose is to secure economies and other advantages in selling.

Circular mergers had their inception in the food industry following the severe deflation of 1920. How and why they started is clearly stated by Colby M. Chester, Jr., president of the General Foods Corporation. He says:

"Changes of style and installment buying proved to be the panaceas for some, but they offered no solution for the problems we of the food industry had to face, and combinations or mergers were studied as never before as possibly presenting the best way out of the difficulty.

"Now there was nothing new in the idea of combination. The past thirty years or so were replete with combinations of various kinds; nor was there anything in the combination of the old order which could meet the particular problem we of the food industry, and particularly of the Postum Company, had to face.

"Forty-eight thousand manufacturers were seeking the consumer market through the established channels of trade. Jobbers, chains and independent retailers were besieged with sales representatives, each asking an advantage for their particular product. Trade practices were a series of experiments subject to constant change and modifications, and the isolated manufacturer found himself in the fog

of uncertainty. Further a unique development had taken place in the distributing field evidenced by the enormous growth of the chain stores.

"Manufacturers must take cognizance of these things and modernize their own distributing machinery.

"With these conditions facing it, the Postum Company took account of stock. For some time past, we had successfully merchandised several nationally advertised products through one sales organization, and the experience created the conviction that an efficient organization, national in scope, could maintain jobber, chain and retail contacts and widen its line by the addition of several new products, and at the same time do justice to each one.

"This idea was put into execution early in 1926 with the merger of the Postum and Jell-O Companies. Other mergers followed rapidly and at the end of 1926 four companies were operating under one executive management and merchandising their products through one sales organization.

"As experience was gained, the plan broadened and duplicate organizations were created to handle other groups of products, until there were five separate sales organizations, each one doing the work formerly performed by several, handling some eighty products under the name of the Postum Company.

"A uniform policy has been adopted for all and executive direction still emanates from the same source. There were certain underlying principles

that governed this expansion program. Each product coming up for consideration must present certain qualifications; it must be non-competing with its affiliated products; it must have established consumer acceptance; it must be a leader or near leader in its own particular line; must have a consistent record of earnings and have been sufficiently long in business to have an assured stability.

"The advantages of the plan soon became obvious. We had combined the brains and experience of several companies as well as the products which they manufactured and while material reductions in sales and executive expense quickly followed, these were perhaps not the greatest benefits which the circular merger created.

"Uniform policy in meeting the outlets of distribution on the part of so many companies was a most important contribution. Our united experience and greater resources enabled us to develop our scientific research and to broaden our understanding of some of the important principles of advertising. It was more than a merger of balance sheets and properties. It brought together the good will of a number of institutions and enabled us to get a much fuller appreciation of the value of good will.

"Our experience to date gives positive evidence that definite inroads have been made in the cost of distribution while sales of individual products have increased. At the same time, wages have been maintained and in some cases profits to the distributor have been increased and lower prices to the consumer have been inaugurated."

The original Postum Company made cereal foods and coffee substitutes. Its first additional acquisition was the Jell-O Company in 1925. A year later Swansdown Flour and Minute Tapioca were added. Walter Baker & Company, manufacturers of chocolate and cocoa products entered the fold in 1927; as did the Franklin Baker Company, maker of shredded coconut. Log Cabin Maple Syrup and Richard Hellman & Company's family of mayonnaise and salad dressings were acquired in the same year.

In 1928 Postum acquired Maxwell House Coffee, Calumet Baking Powder and the La France Manufacturing Company's line of laundry powders and tablets.

During 1929 the company took over a manufacturer of concentrated fruit powders, the Diamond Crystal Salt Company, the North Atlantic Oyster Farms, the Birdseye process for quick freezing of food products and a New England packing company.

Mr. Chester has been kind enough to let me cite figures to prove his statement that "definite inroads" have been made by General Foods Corporation in the cost of distribution.

Here are the figures on distribution costs:

Year	*Selling Cost in Per Cent of Sales*
1922	34.7%
1923	32.4
1924	30.6
1925	24.7
1926	25.4
1927	25.1
1928	23.2

In six years the cost of selling has fallen from 34.7 to 23.2 per cent—a decline from the 1922 level of 33 per cent. According to Mr. Chester, this reduction in selling expense came primarily from the bringing together of the sales organizations of several companies into five groups resulting in a material reduction in the number of salesmen.

Now it is interesting to see that even though the company achieved such notable economies in selling, it had not at first gone as far in consolidating sales as to an outsider would seem easily possible. As we have seen, it still maintained five sales groups, all calling on the same trade and so to a great extent resulting in duplicated effort.

It is not surprising, therefore, that in 1929 a single selling company, General Foods Sales Company, Inc. was formed to take over the work of the five subsidiary distributing companies.

Under this plan all products going to any one class of trade are handled by the same sales force. Grocery salesmen sell all grocery products to groceries, another group specializes on sales to institutions, and so on. This resulted from experience indicating that it was preferable to have each salesman sell more products to fewer customers and at the same time to specialize not on products but on types of customers. This enables each salesman to know his trade better and to get around to see his customers more often.

While it is not as yet certain that this plan will result in fewer salesmen, it is definitely expected that it will greatly increase the effectiveness of the

selling effort which should in time reduce costs somewhat.

A great variation is to be found in the extent to which circular mergers have reduced their selling forces. Before one such merger acquired a smaller company, the number of salesmen employed by the two companies totaled 375. It was decided that this force could be materially reduced. It was—to a total of 125.

On the other hand, it appears that the apparently obvious savings from having each salesman sell a more or less complete line of allied products are not always attainable. There is, for example, the case of several manufacturers of office equipment who drew together into what seemed to be a logical circular merger. The theory was that a man experienced in selling, say, typewriters, to an office should be able also to sell filing cases or card index systems. But it was found that he could not. Each product of this merger was a specialty and it took a specialist on that product—not a specialist on offices in general—to sell it.

So after an unsuccessful effort to pool the selling of its products, this company has gone back to using separate selling staffs.

If one were to base his argument upon the experience of General Foods, he could show clearly why and how circular mergers save on the cost of distribution. Basing his deductions on the just cited circular merger of office appliance concerns, he would be forced to the conclusion that no such economies are possible.

The truth is, of course, to be found in neither extreme. Certain products are so closely related that they can readily be sold by the same salesmen. While these may be of the nature of specialties as opposed to staples, they are not such specialized specialties as are machines. Broadly, it can be safely generalized that when a salesman must have a more or less technical knowledge of his product and of what it will do, it is unlikely that he will be able successfully to handle more than one product.

But when the products fit into or complement each other as do some paints and varnishes, and most food products, it is an advantage for him to sell what the buyer considers to be a full line.

I have discussed the General Foods Corporation's experience at some length not only because of its typicalness of modern circular distribution mergers, but because it was a pioneer of that form and has been in existence long enough to have demonstrated the practicability of the set-up. So successful has it been that keen business men have been impressed with the possibilities and there are now several similar mergers in the food and other industries.

One of the more recent ones is Standard Brands having as its nucleus Fleischmann's Yeast, Royal Baking Powder and others.

One of the dominating motives underlying the formation of this merger is the widespread, highly effective distributing system for yeast possessed by the Fleischmann Company. Probably no other concern covers its field so extensively and intensively. It might just as well be utilized for the

distribution of many products as for the few for which Fleischmann used it. The savings would seem to include not only direct selling expense but the physical distribution as well.

Even in those cases where the direct expense of salesmen's salaries and expenses or even the advertising of the various products cannot be reduced, it is usually possible to effect economies in other elements of distribution by the consolidation and elimination of warehouses, branch offices, credit departments and the multitudinous duplication of clerical work involved in the selling activities.

The merger of American Radiator and Standard Sanitary Manufacturing Company is effecting many such economies. In another case 200 clerks and sub-executives have been eliminated from the combined accounting departments whose work was concerned with records and accounts involving sales.

It does not follow that the distribution economies cited as possible to various types of mergers will always be achieved in toto, nor that they can always be realized upon to the fullest from the start. But the possibilities exist in every merger and to a skillful management the existence of possibilities for cost reduction is all the incentive that is needed to achieve them.

CHAPTER V

Administrative Economies of Consolidation

IT is frequently a matter of comment and criticism that the operating statements of many mergers do not reflect the economies in general and administrative expenses which, on the surface, it seems should be so easy to achieve. To most outsiders it appears that it should be far easier to effect savings in executive and clerical payroll than in either production or distribution costs. And, as a matter of fact, it usually is, through eliminating duplicate executives and by consolidating and centralizing various functions of the business.

It is fairly obvious that several competing concerns will of necessity have a rather complete duplication of executives. Each concern has a president, a vice president or two, probably a treasurer, a credit manager and staffs of clerks and others whose salaries all go to make up that large item of overhead, "general and administrative expense."

Nothing, it would seem, should be simpler when companies are merged than to eliminate all but one president, one treasurer, one credit manager and the like. It should also be easy to consolidate other activities such as clerical work of one kind or another, research, advertising and so on.

Actually most mergers do effect well worth-while

economies along those lines although in special cases it may not be possible, or politic, to make them suddenly and all at once. Later in this chapter will be found a number of typical instances showing how, and the extent to which, such economies in administration have been made by mergers in several fields.

It seems well first to point out why it is that in the face of sometimes material savings in administrative expense it is not uncommon for that item to be larger for the merger than it was in total for the individual companies merged.

The critics of mergers commonly fail to take into consideration a fact well known to industrial engineers and to all really capable business executives —namely, that it is often the part of wisdom for a business greatly to increase its expenditures for overhead expense, in order to secure economies in other phases of the business, which will far more than offset these increases and so give a much reduced total cost.

Take a few examples. No competent production man would hesitate to spend money, if it were available to him, to buy a machine costing $25,000 and simultaneously junk his present $10,000 machine if the net cost of performing the operation would be reduced. Yet the carrying charges of that machine will increase the overhead expense of the operation.

More pertinent to the subject we are discussing is the building up of a research, a cost accounting, or a production planning department the salaries of whose staffs may greatly increase the budget for

general expense. Yet if the methods used by such "non-productive" departments are well fitted to the specific needs of the concern, they practically always result in reducing the total cost of making the product and sometimes of selling it.

Many an independent company has saddled upon itself a considerable annual outlay, often for a period of several years, for research either in pure science or into the more "practical" fields of new products or of distribution methods. The general expense item went up, of course, but if the work was well done and intelligently guided and if the effort enjoyed a modicum of good luck, the company benefited from the outlay.

As a matter of fact, it is frequently true that those companies which have the highest proportion of overhead expense in their cost, have the lowest total costs, provided always that the high overhead is the result of judicious expenditure, and not mere extravagance. What is true in this respect of the individual company is at least equally true of a merger of several such companies.

In fact, it must not be forgotten that a common and perfectly proper reason for a merger may be concentration of capital to an extent which will enable the merger to undertake activities of a general nature too expensive for any of the unmerged companies to carry on for themselves.

Research on a large scale is a usual example. So is increased advertising. The employing of exceptionally high priced experts is another. Large chains of retail stores frequently employ staff men at

salaries far beyond the reach of an individual store or even of a small chain, to render expert advice on merchandising, store arrangement, store location, employee training and many other elements of the business. A highly successful department store owner who foretells huge mergers of existing department stores into nation-wide chains—a step that is well under way as this is written—maintains that it will be as economical as it will be possible for such chains to employ buyers and other specialists at salaries as high as $50,000 a year or more.

Mergers of industrial companies likewise employ high priced experts to advise on matters not only of distribution but on various phases of production, traffic and a veritable multitude of other highly specialized functions.

Certainly it would be difficult to find more capable executives than those who hold high positions with General Motors, General Electric and a number of the other highly successful mergers. Salaries of $100,000 are not rare in those organizations and the total remuneration of some of these executives counting bonuses and so on is reputed to reach $1,000,000 a year. There is probably only one company in the world which has grown without recourse to merging that could afford to pay men of such caliber the prices they demand, and are worth.

The foregoing may superficially seem to be a plea for extravagance in administrative and general expense by both mergers and independent concerns. It is not at all. It is, rather, merely an explanation of why the total expense for those items does not

always show such marked decreases after merging as seem obviously possible to the outsider.

The truth is that even where great additions to general expense have been made along the lines suggested, the total is not raised to that extent because of economies which have been effected in sufficient degree to nearly if not entirely offset the increases.

But it is also true that these economies are by no means easy to effect, as a rule. Sometimes it may even be several years before the economies are achieved to the fullest.

There are several reasons for this.

For one thing, it is not the part of wisdom to undertake a thoroughgoing housecleaning and reorganization all at once. To do so might result in such a disorganization both of methods and of personnel as to be all but fatal to the new business. It may seem simple to eliminate, say, all accounting which is done at branch plants and concentrate it in the central office; but to do so too suddenly would probably result in there shortly being no records at all or at least none of any great value. Such concentration can only be successfully done piecemeal, often over a period of months or even perhaps of years—and then only after a careful and comprehensive study by experts and the designing of a new method suited to the peculiar needs of the business. For it must not be forgotten that usually a merger is a radically new business and not, as is too often assumed, merely an association of old businesses. The policies of the new business may

be and probably will be entirely different from those of any of the individual units.

We are speaking here, of course, of mergers of several concerns all of which have heretofore been entirely independent. When an existing merger or even a large independent concern absorbs a smaller one, the problem is much simpler, although even so it is seldom possible, or advisable let us say, to make too sudden and drastic cuts in the administrative personnel of the acquired business.

But let us now consider those savings in administrative and general expense which experience shows *can* be achieved ultimately.

First, there is the elimination of executive talent which existed in excess even in the merged units as individual companies. In an unusually well-managed concern there is, of course, little of this, but unfortunately not all independent companies are so well managed. A great many of our modern mergers are at the outset made up of closely held family concerns which are looked upon by the owners not only as profit producers but as institutions in which none too bright or able dependents can be confined during working hours at salaries far in excess of what they could get elsewhere. Very likely Grandpapa, who founded the business, holds the title of president or chairman of the board at a salary of from $15,000 a year up. Brother Bill is vice president in charge of sales at $20,000 and cousin Albert is sales manager at $15,000. Second cousin Fred probably assists him for the stipend of $7,500. If Fred has reasonable ability he could

probably do all the sales managing needed—thus eliminating a vice president and a sales manager.

This may seem exaggerated—but it is not. We have seen moderate sized concerns with a dozen or more such excess executives who held jobs in lieu of becoming remittance men or receivers of charity in some other less acceptable guise. In one such instance a young in-law drew upwards of $10,000 a year as assistant treasurer—a job usually necessary only in rather large and far-flung concerns.

The president of one nationally known merger estimates that, at a minimum, savings of 33⅓ per cent in administrative salaries alone have been made in the privately owned companies which his concern has acquired, by eliminating excess general staff which he says is "invariably found due to the accumulation of surplus executives through lack of outlet or through the acquisition of relatives of the founders." That strikes me as a conservative estimate taking all privately owned concerns as a group. For a large part of them it is, my observation indicates, far too low.

For his merger as a whole and including all manner of possible economies, this man, who is a most able administrator, sets the savings in administrative expense at 66⅔ per cent. One reason for this saving which he stresses is that his consolidation sets a high standard of administrative efficiency and energy. He tolerates none of the scenery either in office fixtures or personnel which some consider essential. There are no purely decorative vice presidents or assistant treasurers in his concern.

A merger of ice cream manufacturers recently bought another small group of factories, coincidently with which it arranged for the retirement of five inactive executives of the acquired properties with an immediate saving of close to $40,000 a year in salaries—which figured out to be the equivalent of just about one cent a gallon on the ice cream production which was purchased.

A merger of four moderate sized retailers was able from the very start to reduce the salaries of executive personnel to the tune of $75,000 a year, which is about 1.5 per cent on the total business done by the merger, and which, incidentally, is slightly more than enough to provide for the sinking fund on the merger's bond issue.

The saving was accomplished partly by retiring inactive owners of the old companies without salary, partly by eliminating duplication of administrative officers and partly by retaining some former officers at salaries more in accord with what their services would command elsewhere.

To what extent duplication of executive personnel can be eliminated depends upon the type and nature of the merger. In strictly horizontal mergers of formerly competing companies there usually are great opportunities. Sometimes all of the duplication of officers can be done away with. A single president is enough. Commonly the selling can be concentrated under a single sales manager, with perhaps district sales managers if there are peculiar local slants to the selling in various territories. That is not always true and often a single sales executive

can do the work which called for a dozen when there were a dozen competitors in the field.

It generally is necessary to have a production superintendent for each plant, but as a rule factory maintenance and similar staff jobs can be carried on locally by comparatively low grade talent under the supervision of a high grade central director.

A great saving can often be made in the cost of maintaining buying offices or staffs. A merger of flour mills saves two cents a barrel on its product—not on the price paid for the wheat, but on the cost of maintaining duplicate buying organizations and centralizing them in one.

A merger of some 60 wholesale houses is eliminating all local buying. On the average each of those wholesalers employed three buyers. In the larger ones, some of the buyers had assistants. Three buyers with one assistant each now buy for the 60 stores. About 175 buyers have been eliminated at salaries that ranged from about $5,000 to above $10,000 a year each. Furthermore, there is great saving in the accounting and clerical work through concentrating 60 buying offices into one.

The simpler the business from a manufacturing and selling point of view, the more possible it is to operate formerly competing businesses merely on the basis of branch plants. The flour milling merger already mentioned does this. The constituent companies each maintained offices. All but one were discontinued with a resultant saving of $38,000 a year.

All of this discussion may strike the reader as

being distinctly unpleasant from a humanitarian point of view. Some of those removed by mergers from the payroll have grown old in the business, some are incompetents who may have difficulty in securing new jobs and some are poorly paid clerks who have been unable to provide themselves with financial mattresses on which to fall. This is a point frequently brought up in indictment of mergers by sentimentalists and by others more acutely interested who do not feel quite sure that they will be able to hold on to lucrative sinecures in case their companies should join up with a merger.

There are two points to consider in justification of what may seem the hard-heartedness of mergers in chopping off the heads of executives. One is that many of those executives were former owners who have taken out enough in past profits, or by selling out for cash or stock in the merger, to be beyond want.

The other is that while there may be a certain amount of individual suffering, there is a resulting great economic good to the general public. Competent students have demonstrated that in those industries which are dominated by mergers, prices are generally lower considering the wages paid than in those where mergers are not the rule. Duplication of effort and the payment of unnecessary salaries is bound to raise costs and hence selling prices. The loss of the few is thus the gain of the many.

The instances so far cited have all been taken from horizontal mergers. To a less extent it is usu-

ally possible to reduce executive personnel in mergers of the vertical and circular types. At present the member units of a circular merger retain most of the attributes of the independent business, working together largely from a sales angle, at least at first. As they develop, this cooperation usually extends to finance and general management so that greater and greater savings in executive expense become possible.

In completely integrated vertical consolidations where practically the entire output of one plant is used by another, the various merged companies become in effect merely manufacturing departments of the merger, differing from the manufacturing departments of an ordinary factory chiefly in the fact that they are not under the same roof and may be rather widely separated geographically. Obviously in such a line-up great reductions can be made in executive personnel—reductions comparable to those possible in a horizontal merger.

So far, such accurately balanced, completely integrated mergers are rare, although as their advantages are better understood it is possible that more will be put together.

In all types it is usually possible to concentrate much of the statistical, clerical and routine work in a central administrative office with consequent reduction of duplicate effort. The General Foods Corporation, a merger of the circular type, in a single instance eliminated nearly 200 men from the accounting department.

Such concentration often works other advantages

than merely expense reduction. For instance, there is the case of a consolidation of four building supply companies in an Eastern city all of which had formerly been in more or less direct competition with each other. Before merging there were four distinct and separate bookkeeping departments and four credit and collection departments. Today all bookkeeping, passing on credits and collecting is handled by the central office. The direct saving from this concentration is evident.

But, more than that, it has notably reduced the losses from bad debts. It seems that some contractors have a way of buying their requirements from one yard up to the limit of their credit, and then going to another and doing likewise. Frequently, a customer would go in debt to all four of the competing yards until he was extended to four times his proper credit limit and too often ultimately went to the wall as a result. Being competitors the four companies were not inclined to exchange credit information due to fear of disclosing any part of their affairs to the others.

With centralized sales and credit offices, it is now no longer possible for aspiring credit seekers to overextend themselves, and the merger has a much smaller write-off for credit losses.

A most prolific source of savings for mergers and one which, it is generally agreed, has barely been attacked is in increasing the efficiency of the various office departments. Engineers have for many years studied factory production methods and have greatly increased factory efficiency. It is only com-

paratively lately that similar attention has been given to the production of paper work in offices.

One engineer who specializes on office work states that few offices are as much as 50 per cent efficient. He estimates that there are at least 3,000,000 office employees in the country getting wages that average at least $1,200 a year. If he is right in his contention that on the average they are doing only 50 per cent as much work as they could if their work were properly planned and organized, there is a waste of $1,800,000,000 a year—a sum well worth shooting at.

It is to be remembered that many of these office workers are employed by small concerns, where one clerk is called upon to perform several distinct operations, there being not enough work of any one kind to enable him to specialize and often not enough to warrant investment in modern labor saving office machines and equipment. In such small offices it is doubtful if much can be done to reduce clerical waste.

But when many small concerns are merged it is usually possible to consolidate office work to a great extent. There are three ways in which such consolidation and centralization of clerical work makes economy possible.

First, there is the perfectly obvious elimination of duplicated records and routine.

Second, by greatly increasing the amount of work which passes through the single office, as a result of concentrating the work of several offices in one, production methods similar to those used in factories become possible. A small amount of produc-

tion in factory or office cannot be handled in the most efficient way. But a large volume whether of factory or "paper" work can be turned out by highly economical mass production methods.

When there is a large amount of work to be done as a result of consolidating in one office the work of many it also usually pays to centralize the work of each kind. Thus, there may be a central typing department, a central adding machine room and a centralized group for gathering many kinds of statistics on tabulating machines. Batteries of billing machines frequently are indicated. An example of this: As a result of organizing a central adding machine department, one concern was able to do all of its calculating of this kind with a force of clerks no larger than that which had formerly handled it for merely the payroll, cost and timekeeping offices. To achieve such results, however, it is usually necessary to have enough work to do so that mass production becomes possible.

Third, the large concern can afford to spend considerable money for expert help in devising ways and means by which to reduce office costs.

Such experts commonly start by determining just what routine is necessary to the business. Often they find that a large amount of the work done is entirely needless. One concern, which rigidly scrutinized all of the reports regularly compiled by its office for various executives, found that more than a hundred were of no value. Dispensing with them at once eliminated an army of more than 250 clerks, which was 25 per cent of the entire clerical force.

Frequently it is found that other bits of routine are just as useless as were those reports.

Having determined which jobs are really necessary to the proper conduct of the business, the capable office "engineer" will work out the best—that is to say, the most efficient—methods for doing those things.

Office machinery of many kinds, in which the big concern can easily afford to make heavy investments, may well enable one clerk to do the work of several. If there is, say, only a small amount of adding to be done it may not pay a small office to install an adding machine. But when the work of many small offices is concentrated in one office as a result of a merger, there will be enough totaling of figures to be done to keep several operators busy all day at adding machines. Such operators, specializing on one job, become highly skilled and rapid. As a result, the cost of that kind of routine work is cut greatly.

The large concern can well afford to maintain a school in which to train office employees in their work. It is not uncommon for a clerk trained in the scientific method of doing a job to turn out two or three times as much work as he could before being trained.

Another important element in cutting the cost of office work is the planning not only of the office but of the flow of work through it, much as every highly efficient factory plans its production.

To achieve these various economies involves the employment of high priced experts, who are either

permanent members of the staff or professionals from the outside. Usually, too, it is desirable to employ permanently an office manager at a fairly large salary. One small concern can seldom afford such talent, but a merger of several easily can.

One large merger employed outside engineers to do just this type of work with the result that in a short time its clerical expense was reduced somewhat more than $150,000 a year.

To a greater or less extent such savings in clerical work are possible in horizontal, vertical and circular mergers. In more or less completely integrated vertical mergers there is the further opportunity to reduce general expense of both executive and clerical nature through the complete elimination not only of office routine but often of whole business functions.

Sometime ago a survey was made of the cotton textile industry to determine what savings would accrue to a complete vertical merger extending from the raw cotton in the field to the delivery of the finished product to a retailer. Counting everything —manufacturing, selling and the various general and administrative functions—there were sixty-five separate activities. Of these, fifty were elements involving general administrative or clerical expense. One group of activities revolved around the raw material merchant or broker; the next involved the manufacturing—spinning, weaving and finishing; the next, selling agents and factors, and finally, the jobber.

Each of these groups sold to the next in line, thus involving both selling and buying departments with

their respective clerical departments for billing, shipping, delivering and paying bills as well as general accounting. In each group there was also expense for credits, collections and bad debts.

It was found that many of the items of expense involved in manufacturing and selling could be reduced or eliminated; but here we are concerned only with the reduction in general administrative and clerical expense which would be possible for a vertical merger.

Of the fifty expense elements included in that classification, we found that six could be entirely eliminated. These six included such elements as credits, collections, bad debts and the extension of financial aid to suppliers, purchasing, and much of the bookkeeping of intercompany transactions. Of the remaining forty-four elements of general expense, no less than forty could be materially reduced as a result of a vertical merger which would enable concentration and consolidation of the activities. Aside from the usual clerical, accounting and executive expenses due to duplication of effort, considerable savings were possible in such items as legal expense, insurance and the like.

Taking into account all of the elements that went into the final cost of the product—including direct manufacturing and selling—we found that no less than 14 per cent of the elements could be entirely eliminated and 62 per cent of them greatly reduced. Only 24 per cent of the activities would be unaffected, cost-wise by such a merger in the cotton textile industry.

We believe that any industry so studied would

present comparable possible savings in these various items of overhead expense. Of course, the more steps there are between the raw material and the ultimate finished product, the greater will be the possibility of eliminating or reducing cost items, for a large part of this expense arises from intercompany accounting and recording necessitated by the selling and buying function between supplier and customer. In a completely integrated merger this is, of course, eliminated.

It is to be clearly understood that such savings as have been described and exemplified in this chapter do not come automatically as the result of a merger. They necessitate thoughtful study and analysis plus persistent effort on the part of the management. There are usually many obstacles to overcome, such as the tendency for minor executives as well as the rank and file to persist in the old traditional ways of doing things and the wholly human desire to hold on to one's job.

To reduce general expense items safely calls first for a carefully worked out and comprehensive plan covering the entire business in all its phases and branches, and then firm but tactful effort.

While on the surface it may seem to be more difficult to reduce these expenses in a merger than in an individual business, the ultimate results are nearly sure to be more impressive, for the mere fact that several companies have merged opens possibilities much greater than existed in the unmerged units

CHAPTER VI

Putting a Merger Together

FROM the point of view of the promotional problems involved, proposed mergers can be conveniently classified as of three kinds—mergers of theretofore independent enterprises, mergers of mergers, and the absorption of an independent company, or a small merger, by a larger one.

The first type commonly presents all of the difficulties that arise in the latter two—generally in more acute form. So in this chapter, we shall for the most part discuss the methods which experience shows to be most effective in putting together a merger of previously independent companies, starting from scratch. In that way, it is felt, the chapter will be of the most value to that large group of business men who, if the present trend continues, are quite likely to be involved in the formation of some merger before long.

The first step in putting any merger together is to determine definitely that there are sound economic reasons for forming the proposed merger. There are not, always.

What constitutes sound reasons have been discussed in considerable detail in Chapter I. Briefly they may be summarized as:

1. Economies in production, distribution, administration or finance.

2. To "clean up" an industry by doing away with cutthroat competition, or gross overproduction, especially by inefficient producers.

These two broad classifications include all of the sound reasons for merging.

Unfortunately, the real reasons underlying the formation of some mergers are not at all sound, although they are as a rule adeptly made to appear so. Any careful and conservative banker would make entirely sure that any merger situation on which he was approached was conceived for a better reason than merely to provide some promoter with a fee, to enable a sell-out or two to be staged, or to provide the vehicle for stockjobbing operations. It is well, in those merger promotions into which the banker does not enter, for those who contemplate going into the merger to follow the same general methods of investigating the economic soundness of the proposed merger that a banker would use.

Such an investigation naturally falls into two parts—first, a study of the conditions in the industry as a whole and often of other closely related industries, and second, a detailed study of the concerns which it is proposed to take into the merger. Needless to say, the comprehensiveness of these studies will vary. A large merger of a great many concerns in the cotton industry might well warrant a thorough economic, engineering and distribution study of the entire industry and even of world markets. It might be highly desirable for the investigation to cover all elements of the business

from the cotton field to the ultimate consumer of a cotton garment. On the other hand, when a manufacturer proposes to buy or merge with a chain of retail stores in order to assure himself of adequate outlets for his product, it may not be necessary to make any general economic survey of the industry. An investigation of the specific stores may be enough. The important point is then, "Will these stores provide the outlet I need, at a profit?"

It would hardly be feasible to list all of the possible points to investigate for all possible types of mergers in all possible industries, but the following may be suggestive.

For the broad economic survey the points to include could well be:

1. Is there overproduction? Will the merger tend to reduce this?
2. Is there a growing or at least probably stable market for the production?
3. Is there ample possibility of the merger effecting improved competitive conditions in the industry?
4. Will the merger reduce wastes due to uneconomic invasion of distant territories with cross hauls, etc.? Will the merger be able to serve a national market to good advantage due to strategic location of plants geographically?
5. Will this merger result in the bulk of the business being done by a few strong companies, or will there remain a large number of independents all scrambling for business?
6. Is the industry one in which it is finan-

cially and otherwise easy for new competitors to start up?

7. Are there advantages to be gained by vertical integration, such as control of raw material supplies and of outlets, by elimination of interplant selling, accounting expense and so on? To what extent will it be desirable to carry out the vertical integration?

8. Can the merged plants make use of each other's chief products and by-products?

9. Can centralized research be carried on at a saving through elimination of duplicated effort, or on a scale impossible to the individual companies?

10. Can the same be done with advertising?

11. Can the various products be produced more economically by concentrating the production of each in separate factories?

12. Will centralized, pooled buying result in worth-while savings in price?

13. Can the products of the merged companies be sold as a family with resulting savings in distribution expense?

14. Will it be possible to effect savings by eliminating duplication of executive and clerical personnel?

As to the studies of the individual businesses which it is proposed to merge, the following points may well be covered:

1. Will a sufficient number of the most capable managers remain with the merger?

2. Are the plants efficient producers, or ca-

pable of being improved under more skillful management?

3. Are the plants well located as to raw materials and markets?

4. Are they modern, or will it be necessary to spend large amounts of money on them or even to close some of them down?

5. Do the individual businesses stand well with the trade?

6. What have been the net earnings of each company during the past five years?

7. Are any of the companies involved in patent difficulties which might affect the position of the merger?

For the rest, the survey of the individual companies will cover the engineering and accounting points on which information would be required by a banker for a piece of simple financing without merger complications.

Those who have had experience in putting mergers together are not all of one mind on certain requisites of the sound merger. For example, basing his position on his own experience, one man maintains that the old adage "a chain is no stronger than its weakest link" holds absolutely true as regards mergers. He states categorically that without exception weak sisters have no place in a made-to-order business family.

Another, whose experience is in an industry that has been passing through several unhappy years, holds that mergers can be successful even if made up almost wholly of heretofore unprofitable busi-

nesses. Being a proponent of mergers as the panacea for the numerous ills of his industry, he is bound to take that stand, for it would be all but impossible to make up a merger in his field with less than 50 per cent of weak sisters. He may be right, but he has found it hard to convince bankers that he is. Our own firm has pointedly declined to consider some two dozen proposed mergers in that industry.

Here we have a condition that varies widely. In one case it might be possible to rejuvenate a senile industry by putting together a sufficient number of concerns all of which have been persistently losing money. Such a case might be one where there were a great many small, unenlightened concerns cutting each other's throats. But even though such an industry were otherwise sound and the units reasonably efficient as producers, it would be a dangerous experiment—far too hazardous to interest conservative bankers.

If a few weak units in an otherwise strong merger are in their sad condition chiefly because their former management was incompetent, it might seem safe to assume that under the skilled management which a merger will enjoy they might be quite easily strengthened and made into profitable units.

On the other hand, it might seem that a chain of department stores would be the type of merger that could take in one or two units which had been falling behind, secure in the knowledge that the strong central management could quickly put effective methods into use in weak local stores and bring them up to standard. Yet a man who knows from first-

hand experience a great deal about mergers of retail stores says that he believes no store should be taken in that cannot make a worth-while contribution to the merger. He admits that the chain might survive a few weak links, but he doubts whether it is worth the effort necessary to pull up weak concerns.

He points out that centralized management, no matter how skillful, cannot successfully operate the local stores. Strong local management is needed, supplemented by help from the central organization. The local management is as a rule of greater importance in retailing than in manufacturing.

On the whole, it is safe to say that it will pay the promoters of any merger to scrutinize carefully any weak concern it is proposed to take in, with the suspicion that such an acquisition is likely to prove costly in the end. If there are strong reasons for taking it in, such as a highly strategic location or an impressive asset of good will in the trade, and if it seems certain that under new management the old weaknesses can be cured, it may be advisable. But a heavy burden of proof lies on the weak sister to prove that she can be reformed.

When the proposed merger is to be made up of formerly independent concerns, it is usually wise not to be too ambitious at the start but to go slowly, merging a few of the outstanding units in the industry first and increasing the size of the merger by gradual steps. There are several reasons for this.

First of all is the problem of getting erstwhile competitors to work together. Commonly, they have been fighting tooth and claw for years. Each

considers the others the greatest rascals unhung. Theoretically, all may agree upon the necessity of cooperating in a friendly spirit, but accomplishment often lags far behind the will. Then there is nearly always sure to be great rivalry for leadership among those who come in. It is not easy for one who was formerly the undisputed boss of a village of Gaul, to accept gracefully a subordinate position even in Rome. Yet all can no longer be leaders.

Now obviously it is easier to get a few such men to reach an amicable state than to get a large number to patch up their differences. Having achieved a peaceful status among, say, half a dozen, it will be easier to handle newcomers later.

Again, there are many difficulties to be overcome and problems to be solved at the start of any merger. The fewer concerns there are in the merger at the start the less will be the volume of work to be done. Once policies have been settled upon and the new merger is functioning smoothly as a single business, it will be much easier to assimilate additional units smoothly and easily.

The business man who has never experienced the "hell period" of the early days of a merger is often prone to underestimate the troubles involved. One who has been through them once is commonly convinced that it is all but impossible to overestimate them. It can be safely taken for granted that all is not going to be smooth sailing when former competitors first join forces.

There is also a distinct financial advantage in starting with only a few carefully selected, well-

balanced and well-matched units. Soundly conceived and ably managed, such a merger stands an excellent chance of developing into a highly successful, profitable business, with which other companies in the same or logically related industries will be anxious to merge.

Therefore, a successful merger can usually acquire additional properties on much better terms than it could have at the outset. Commonly the owners of the to-be-acquired concerns are willing—even anxious—to take stock in the merger in exchange for their own holdings. Where it might have been necessary when the merger was formed for the stock to be exchanged on a share for share basis, after a few years the merger may well be able to secure the same property at the rate of five or ten shares for one.

Incidentally, this often solves the problem of how to take care of inactive but high salaried owners whose services are not required by the merger but who tenaciously hang on to their sinecures. Several successful mergers have found that such hangers-on often quite willingly give up their salaries in exchange for a well-seasoned, listed stock even though the dividends are considerably less than their former salaries.

Although it is usually heartrending for the promoters or other sponsors of a merger to give up even for the time being the realization of their dreams of a mammoth, dominating consolidation, it is usually the part of wisdom to do so. Later the other independents can be secured. Or, as often

happens, the formation of one merger may lead the independents to form one or more mergers of their own. After they have all passed through the seasoning process, it may be comparatively easy to draw them all together into a super-merger. Many of the acquisitions of leading mergers today are of companies that are themselves mergers.

But to go back to the initial steps when several independents are being drawn together.

One of the first problems, and a basic and important one, is "Who should take the leadership in putting this merger together?" Some one usually has to sell the idea to the various companies. That done, it is no easy job to compose the various conflicting interests involved. Excessive prices are demanded for properties; arguments arise over personal precedence in the management; and, often, these conflicts degenerate into disputes or into downright cat and dog fights.

There is less of this when the merger is to be of either the pure vertical or the circular type for then those who are merging are not all competitors. If it is a vertical merger, many of them probably have been doing business together as buyer and seller and so have learned to compromise and to get along on a basis of give and take.

But the horizontal merger made up of competitors as a rule presents great difficulties. That is only natural for quite likely they have been stewing for years in a sort of devil's cauldron of cutthroat selling, patent infringement suits, broken promises and all sorts of unscrupulous, predatory practices.

Some successful horizontal mergers have been put together by leaders within the industry who have the respect and the confidence of the others. Such a leader may be the chief owner of one of the larger units in the industry, or perhaps a trade association executive or a lawyer well known in the trade and thoroughly conversant with it.

But if the merger is to be promoted by a man within the industry, he must be indeed a most unusual man, for having a personal interest in the industry, he is bound to be more or less under suspicion and he is also practically certain to have enemies.

So great are the difficulties that it is often wisest to seek the aid of some professional promoter who has had no previous connection with the industry, for he will be less open to suspicion of having entangling alliances or personal interests to safeguard or advance. Furthermore, he will know how to present the proposition to bankers in proper form if banking help is needed, and which bankers are interested in certain types of mergers and which are not. This is important, for bankers specialize to a considerable extent and it is a great waste of time and effort to peddle a proposed merger around indiscriminately.

A common practice is for the professional promoter to charge a cash retainer fee sufficient to cover his actual expenses. If the merger is not consummated the promoter makes no profit. If it goes across, he gets a block of stock. If the merger succeeds, he may have a nice profit for his efforts; if

it fails, his stock is worth little or nothing. For that reason, capable professional promoters are not likely to waste time on a proposed merger that is obviously unsound or too risky.

It may be instructive to outline some of the methods used by one promoter who has been unusually successful in harmonizing and finally merging many groups of discordant and antagonistic elements.

At the start when all are for the moment at least more or less at peace around a table, he announces that none of the individual owners will receive any cash for his business. The merger, he states, will be consummated by an exchange of stock of the merger for stock in the new company. This statement commonly precipitates a near riot, but it has the beneficial result of showing which of the group look upon the merger as a vehicle for a sell-out and which really want to merge for the ultimate good of their business. That accomplished, the undesirables are weeded out and there is a sounder basis on which to proceed. Later on in the procedure, this requirement is often relaxed, for it may be highly desirable to pay off some men in cash in order to get rid of them completely. However, it is usually sound strategy at the start to discourage those who are interested solely in selling out.

Also this promoter, in the early stages, asks the various owners to refrain entirely from discussing the prices they expect or hope to get for their properties. He knows that to be one of the most dangerous of all topics, for acrimonious discussion of

prices has wrecked many otherwise promising mergers. So he encourages the owners to confine their conversations to such safe and attractive topics as prospective economies and the consequent increases in earnings which the merger will bring. If they tire of such themes, they may at a pinch discuss the broader general policies of the new business.

While this promoter encourages discussion of the probable economies—for he feels that increased economy of operation is the principal economic reason for mergers—he does not promise economies. He studies conditions and arrives at quite definite convictions of his own as to what those economies and betterments will amount to in dollars and cents, but he never gives any consideration to them in prospectuses and financial statements. He knows that while economies in production, distribution and administration commonly result—they may not show in increased earnings for two or three years.

So his statements are set up solely on the basis of actual operations of the merging companies. But in order to make them truly representative of the earnings, the operating statements are adjusted, if necessary, to make them strictly comparable. For example, only rarely do several companies even in exactly the same industry follow identical or even similar policies in figuring depreciation. One may base its depreciation for a period on the gross profits for that period, charging off heavy depreciation when profits are large and but little in lean times. Fortunately the income tax has made this less customary than it once was. However, it is seldom that two

companies apply exactly the same rate to similar buildings and equipment. Further differences may exist in the handling of reserves, inventories and other items.

Again, some of the merging companies may have deducted in past earning statements certain unusual items of expense which by no stretch of the imagination would occur again. It is perfectly proper to reflect adjustments for such items in the consolidated operating statements, and, as with corrected depreciation rates which will affect the value of fixed assets, in the statement of condition.

Such adjustments not only give a true picture to the bankers—they provide a fair basis on which to evaluate the businesses. Of almost equal importance, such statements tend to minimize if not to eliminate the haggling and jockeying for price advantages which so often result in well worth-while mergers failing of consummation. Imaginative, inaccurate or merely incomparable financial statements provide an inadequate basis for merging but a perfect basis and background for argument and haggling. Sound, comparable and accurate statements discourage it.

When the earlier so-called "trusts" were being formed, the customary practice was to base the sale price almost wholly upon the figures shown in the statements of condition. It was held that the value of a business was the value of its net assets. The earning power came in as a rule solely as a basis on which to issue common stock to be sold to the public while the old owners got theirs in bonds and pre-

ferred stock—usually with a sweetening of common dependent chiefly upon their bargaining ability.

Net assets in those days were seldom carefully evaluated; on the other hand, they were commonly highly fantastic. In the controversies which arose out of some of those early consolidations, it was not uncommon to find "expert" opinions varying widely as to the fair values of the assets. For example, in the estimated value of the United States Steel Corporation's assets at the time of its formation, the spread in round figures was the difference between $300,000,000 and $1,400,000,000, to a large extent due to optimistic estimates of the values of unproved mineral deposits.

Today, we give more weight to demonstrated earning power than to physical assets, for we realize that the sole purpose of business is to earn profits and not to provide hockable brick and mortar in case poor management or, less often, acts of God prevent the realization of profits.

Thus the assets behind a security are becoming increasingly unimportant as the bankers and the public learn through experience that the values shown on a balance sheet are rarely realized in the event of the failure of an enterprise. Assets such as machinery, buildings, etc., possess a value only while a company has momentum—that is to say, while it is operating at a profit. As soon as that profit ceases, the value of such assets decreases sharply. If continued losses are sustained the values ascribed to them often lose practically all of their former significance.

In some extreme cases a disparity between the net assets of merging companies may well be ignored and sole value given to the relative earning power. This was true of a recently proposed merger of two manufacturing companies some of whose products competed directly and some of which complemented each other.

Competent appraisers placed the reproduction cost of one company's plants at about 50 per cent higher than that of the other. Yet, the less valuable plant was in a much better industrial location than the other, as a result of which it appeared likely that in case of liquidation of the assets it would bring as much at a forced sale as the more expensive factory.

The average earnings of the two companies over a five-year period were almost exactly the same. So it was decided that the only fair plan was to base the exchange of securities solely on earning power.

As we said, this was a somewhat extreme case. A more usual plan is to give weight both to the value of assets and to earning power.

One way* which has been found in many mergers to give results fair to all is to assign twice as much value to the earnings as to the assets in working out the price to be paid for the properties.

Suppose, for example, that the merger is in an industry in which it is currently felt that ten times net earnings is a fair ratio. Let us take the four concerns shown in the table on following page.

* Frequently used by Holton Richards & Co. in putting mergers together.

A	*B*	*C*	*D*	*E*
Company	*Net Tangible Assets*	*Net Earnings*	*Value of Business on Basis of 10 Times Net Earnings*	*Valuation for Purpose of Selling to Merger* $= \frac{B \text{ plus } 2D}{3}$
1.	$1,000,000	$100,000	$1,000,000	$1,000,000
2.	400,000	100,000	1,000,000	$\frac{2,400,000}{3}$ = $8000,000
3.	800,000	80,000	800,000	$\frac{2,400,000}{3}$ = $8000,000
4.	1,200,000	60,000	600,000	$\frac{2,400,000}{3}$ = $8000,000

The first has net tangible assets of $1,000,000 and net earnings of $100,000. Capitalizing the earnings on the agreed upon 10 to 1 ratio, we get $1,000,000. Giving it twice the value of the assets involves adding the million of assets to twice the capitalized earnings and dividing by three. The formula for this procedure can be expressed as:

$$\frac{\text{Net tangible assets} + 2X\ (\text{Earnings} \times 10)}{3}$$

The table above is particularly interesting in showing how three supposititious concerns having net tangible assets as far apart as $400,000, $800,000 and $1,200,000, respectively, can have the same value to a merger—$800,000—when proper consideration is given to their respective net earnings.

Needless to say, it is unlikely that three concerns in the same industry would have such wide variations in the ratio of earnings to net assets. The figures used were chosen for the sake of emphasizing the importance of the earnings in arriving at the value of a property.

It is not to be supposed, of course, that this formula is invariable and infallible. It is merely one which has been sometimes used and often found to be generally fair to all. Unfortunately it cannot be safely assumed that, fair as it so often is, it will be willingly accepted by concerns whose net assets are high compared to their earnings. Even though in a specific case it appeared to be absolutely fair, the extent to which it will be used as a guide will depend largely upon the relative bargaining power of the business men who contemplate merging. Although right now it is more or less the style to think of business men as always conducting themselves in accord with proved scientific principles, as sticking to the "one price" policy and as cooperating for the common—and especially the public—good, it is foolish to assume that bargaining is a lost knack in commerce and finance. Compared with a man jockeying to get the best price for his business from a merger, David Harum was little more than the village idiot and his much vaunted hoss trading ability as open and naive as a child's request for a penny for candy.

It is probably true that the recent stress upon earning power rather than upon net assets in the valuation of merging companies has been a result of the desire of so many investors to put their money into equities—which is to say, common stocks—rather than into bonds or preferred stocks. The idea for several years has been that the way to get rich is to own common stocks of almost any American industry, on the theory that American

business has discovered a wholly new economic principle, as a result of which there will surely be a continual and great business growth and increase in profits. So much have earnings been stressed by investors that in some industries, it seems likely, prospective earnings for years to come have been heavily discounted.

More recently this has begun to seep into the consciousness of investors and some of them, in increasing numbers, seem to be turning again to bonds as investments. If this trend becomes marked, we shall doubtless enter another stage when earnings will give way to some extent to tangible realizable value of assets as a basis for the evaluation of a property. Of course, earnings will always be of paramount importance for without earnings bond interest inevitably must be defaulted.

When all is said and done the valuation and capitalization of a merger, or any other business, is in the end largely determined by what conservative, large scale investors demand.

So if the fashion in investments swerves from stocks to bonds, there will doubtless be an increasing use of bond issues in the financial structure of mergers. Investors demand adequate, tangible, readily saleable assets behind the bonds they buy. This is bound to be reflected in the method used to determine the value of any concern to a merger.

Whatever may be said of the relative merits of the various methods used in determining the value of a business, it cannot be gainsaid that real physical valuation of property is more mathematically ac-

curate and less theoretical than any attempt to evaluate prospective earnings.

That is not to say that there is anything unsound in the latter, for it is perfectly sound and proper. The point is merely that there can be more justifiable difference of opinion as to the value of a business when the valuation is arrived at largely from a point of view of earnings, than when tangible values are given the greater weight.

Therefore, should the demand for bonds result in more use of bonds in the capitalization of mergers, it is likely that there will be less conflict of interests in the preliminary negotiations leading to the formation of mergers, and that there will consequently be less danger of sound proposed mergers failing of consummation.

Anything which tends to make the formation of economically sound mergers less difficult, and especially less subject to excessive and short-sighted haggling over price, is in the interest both of business and of the public. Fortunately with increased experience business men are gradually developing a fairly definite technique in merger promoting. Even so, the job is no simple one.

We see and hear of so many mergers which seem to go through smoothly that it is easy to forget or not to realize all of the careful work, painstaking thinking and skillful maneuvering that went on behind the scenes by promoters, bankers, accountants, lawyers, engineers, owners and managers. Yet, even a small merger which commands but a line or two of

space in the financial section took months of hard labor of a considerable group.

This work merits the greatest care and skill, for it is the ground-work on which the future success or failure of the merger will, to a large extent, depend. A well put together merger may possibly fail as a result of future developments. A poorly put together one is nearly sure to fail.

CHAPTER VII

The Financial Structure

IN some instances it is easier to work out a satisfactory financial structure for a merger of existing companies than for a brand new independent enterprise. In other cases it is more difficult.

The prospective earnings of a merger can as a rule be quite accurately judged, as to both amount and stability, on the basis of the past earnings of the individual merging companies, while even in an established industry it is almost impossible to estimate the probable earnings of a newcomer in the field. As we shall see later in this chapter, these attributes of the earnings have a potent influence on the capital structure.

Complicating influences, which often make it difficult to work out a proper capital set-up for a merger and which sometimes make it impossible to realize anything approaching the ideal, are: (1) existing capital structures of the merging companies; (2) considerations arising out of the conditions of purchase of the units.

The method by which a merger brings about its centralized control of theretofore independent concerns has a direct and often dominating influence in determining what the capital structure shall be.

For the sake of clearness in considering the possible and desirable financial structure of any pro-

posed merger it seems well to emphasize the various means by which centralized control of subsidiaries may be attained.

1. Simplest of all perhaps is the outright purchase of the assets of one or more operating companies by another operating company. Thus a machine shop might buy out a competitor, lock, stock and barrel. Or it might do the same with a source of supply, say, a foundry. In the cotton industry that type of acquisition has been so common that now it is commonplace for a weaving mill to own outright its yarn mill, or vice versa. However, in selling the assets it is important that, immediately after the transfer, the sellers own at least 80 per cent of all classes of stock of the buying company. Otherwise the transaction is taxable under the federal tax laws.

2. It is sometimes advisable to retain the corporate identity of a company even though all of the capital stock is owned by another. Commonly this is due to local laws which may require that a company doing business in a state be incorporated in that state, or which tax heavily a "foreign" corporation. Or, again, even though it be desirable to merge the assets, the existence of a preferred stock or a bond issue of the subsidiary company may sometimes force the continuance of the corporation until the preferred has been retired or the bonds can be paid off, in spite of the fact that all of the common capital stock is owned by another company.

3. Sufficient control of policies and operations can sometimes be secured merely by acquisition of a controlling interest in the common stock of a com-

pany. If control is desired for strategic purposes, but if the company in itself does not promise to be highly profitable, mere voting control may be all that is desirable. But if the controlled company promises to be highly profitable, the other will probably try to get complete ownership.

4. If the stock of a company is widely scattered, actual voting control may sometimes be secured by owning less than 50 per cent of the stock. This, however, has its perils for, by voting together, a number of minority stockholders may swing control, or an aggressive competitor may buy up enough of the scattered shares to get control. Some holding companies find, however, that they can secure all the influence they need for the sake of a mutual interest by owning much less than 50 per cent of the stock of a strategic company.

Here again the tax laws have an important bearing. If the transfer involves less than a majority of the voting stock, and in addition, less than a majority of the total number of shares of all other classes of stock of the acquired company, the sellers are subject to taxation for any gains so realized. It is apapparent, then, that if a gain will be realized it is desirable from the seller's point of view for the merger to secure a majority of all stock. On the other hand, if a loss is to be established it is desirable that the merger secure less than a majority of all classes of stock.

Some mergers combine two or three or all of these methods of controlling subsidiaries. It is not unusual for a holding company to be at the same time

an operating company. A notable example is the General Motors Corporation. A published statement by the corporation says:

"General Motors Corporation is primarily an operating concern owning the plants, properties and other assets of its manufacturing operations, which are designated as Divisions. It is also a holding company owning part or all of the capital stock of other companies connected with its activities."

Those whose assets are owned by General Motors Corporation are:

1. Buick Motor Division
2. Cadillac Motor Car Division
3. Chevrolet Motor Division
   (This division has several parts manufacturing subsidiaries, all of whose stock is described as "owned by General Motors Corporation")
4. Oakland Motor Division.
5. Olds Motor Works Division
6. Fisher Body Division.
   (Operates body building plants in the states of Michigan and New York and owns timber lands in Michigan)
7. Armstrong Spring Division
8. Brown-Lipe-Chapin Division
   (Manufactures differential gears)
9. Hyatt Bearings Division
   (Manufactures bearings)
10. Jaxon Steel Products Division
    (Manufactures wheels, rims, tire carriers, rim parts and steel stampings)

11. Muncie Products Division
    (Manufactures transmissions, steering gears and chassis parts)
12. Saginaw Crank Shaft Division
13. Saginaw Malleable Iron Division
14. Saginaw Steering Gear Division.

Those companies all of whose stock is owned by General Motors Corporation are:

1. General Motors of Canada, Ltd.
   (Manufactures automobiles and trucks in Canada)
2. Fisher Body Corporation
   (Automobile body building plants in Cleveland and Cincinnati, Ohio)
3. Fisher Body St. Louis Company
   (Automobile body building plants in St. Louis, Mo., Oakland, Calif., and Jamesville, Wis.)
4. Fleetwood Body Corporation
   (Automobile body building plant for custom bodies)
5. Ternstedt Manufacturing Company
   (Body hardware)
6. The National Plate Glass Company
7. Fisher Lumber Corporation
   (Fisher Delta Log Company, subsidiary)
8. Delco-Remy Corporation
   (Manufactures starting, lighting and ignition systems for cars, horns, hydraulic shock absorbers, coincidental locks, small electric motors and lamps)
9. Delco-Light Company

(Electric light plants and residence water systems)

10. Frigidaire Corporation
    (Electric refrigerators, etc.)
11. Harrison Radiator Corporation
    (Automobile radiators)
12. Inland Manufacturing Corporation
    (Steering wheels and rubber and molded parts)
13. United Motors Service, Inc.
    (Provides authorized national service for such General Motors products as starting, lighting and ignition systems; hydraulic shock absorbers; horns; rims, rim parts and wheels; radiators; ball bearings; roller bearings; speedometers; air cleaners, oil filters, gasoline strainers, fuel pumps and gauges)
14. General Motors Export Company
    (Distribution of cars and trucks in overseas territories not covered by General Motors overseas operations)
15. General Motors, Ltd.
    (Distribution of cars and trucks in Great Britain and Ireland)
16. General Motors International, A/S
    (Distribution of cars in Denmark, Norway, Poland, Esthonia, Iceland, Latvia, Danzig and Lithuania)
17. General Motors Nordiska, A/B
    (Distribution of cars in Sweden and Finland)

18. General Motors Continental, S.A.
    (Distribution of cars and trucks in Belgium, Holland and Switzerland)
19. General Motors, G.m.b.H.
    (Distribution of cars and trucks in Germany, Austria, Czechoslovakia, Hungary and European Russia)
20. General Motors (France) S.A.
    (Distribution of cars in France, Algeria, French Morocco and Tunisia)
21. General Motors Peninsula, S.A.
    (Distribution of cars in Spain, Portugal, Spanish Morocco, Canary Islands and Gibraltar)
22. General Motors Near East, S.A.
    (Distribution of cars in the Near East)
23. General Motors Argentina, S.A.
24. General Motors of Brazil, S.A.
25. General Motors Uruguaya, S. A.
26. General Motors South African, Ltd.
27. General Motors (Australia) Pty. Ltd.
28. General Motors New Zealand, Ltd.
29. General Motors Japan, Ltd.
30. N. V. General Motors Java
31. General Motors Acceptance Corporation
32. Argonaut Realty Corporation
33. General Motors Building Corporation
34. Modern Housing Corporation.

In addition General Motors Corporation owns all of the capital stock of the following selling corporations:

1. Buick Motor Company

2. Brown-Lipe-Chapin Company
3. Cadillac Motor Car Company
4. Chevrolet Sales Companies
5. Hyatt Roller Bearing Company
6. Jaxon Steel Products Company
7. Claxon Company
8. Oakland Motor Car Company
9. Olds Motor Works.

General Motors Corporation owns all of the common stock of the following companies:

1. New Departure Manufacturing Company
   (Ball bearings, coaster brakes, bells and bicycle hubs)
2. Vauxhall Motors, Ltd.
   (Manufactures and sells Vauxhall motor cars in Great Britain and Ireland)
3. Delco-Remy & Hyatt, Ltd.
   (Sales and service on Delco-Remy & Hyatt products in Great Britain and Ireland)

General Motors Corporation owns a majority of the stock in the following:

1. Yellow Truck & Coach Manufacturing Company
2. AC Spark Plug Company.

It also owns a half interest in the Ethyl Gasoline Corporation.

Several of the subsidiary companies of General Motors in turn own all of the capital stock of their subsidiaries.

This line-up of General Motors Corporation is given in some detail not because it is particularly

complicated—it is, in fact, comparatively simple—but to indicate how even some of the largest and most powerful mergers sometimes find it expedient to own the assets of certain subsidiaries, all of the capital stock of some, all of the common stock of others and not even control of still others.

In the table on page 135 are listed thirty-one typical mergers. They represent of course only a few of the total, but an effort was made to select typical ones, in many diverse industries and the small and medium-sized ones as well as the largest. The subsidiaries of these thirty-one mergers total—according to the 1929 edition of *Moody's Manual*—792. Since that manual was compiled many of these mergers have made still further acquisitions.

It is to be noted that by far the largest number—76.6 per cent—of the subsidiaries are controlled through ownership of all of the assets or all stock. Less than a controlling interest is owned in less than 4 per cent of the cases. In only 13.3 per cent is control exerted by a majority stock interest.

It is to be remembered that it is not always possible for an existing operating company to act also as a holding company because of failure of its charter to permit it to own securities of other corporations. In that event the formation of a distinct holding company with the necessary powers is indicated.

As we have seen, the General Motors Corporation is at once an operating and a holding company. The American Radiator & Standard Sanitary Corporation, on the other hand, is a holding company pure

and simple, formed primarily to acquire the capital stock of the Standard Sanitary Manufacturing Company and of the American Radiator Company, by exchange of stock.

Frequently for a number of reasons it is impossible or undesirable completely to merge the assets and business of several concerns at the start. In that event the merger may start as a holding company. Later, as the various disabilities are removed, it may gradually evolve partly or entirely into an operating company.

For instance, it is not unusual for a considerable number of minority stockholders to decline the merger's offer to buy them out either for cash or stock in the merger. If the merger can swing a bare controlling interest in the stock a holding company is formed to hold that stock. Little by little, perhaps, through need of money by the stockholders, by the necessity to liquidate an estate, by the passing of minority shares into the hands of those who are not opposed to the merger, or for many other reasons, the minority stock drifts into the ownership of the holding company. Sometimes the merger's stock becomes so desirable that the old stock of the subsidiaries comes in voluntarily and even quickly. However it comes about, it is frequently true that in time the merger may own it all and then in the interest of a simple financial structure it may extinguish the separate corporate existence of the subsidiary and acquire its assets outright.

If only bare control can be secured there usually

is no way in which the assets can be secured by the holding company.

But if from two-thirds to four-fifths of the stock can be secured, depending upon the charter provisions and the state law, the holders of it can vote the sale of the assets to the merger for either cash or securities, in spite of the protests of the minority holders. Usually all these can do is to protest that they are not being paid enough for their interests and appeal to the courts or to a board of arbitration to appraise the value of their minority stock.

When underlying securities of several subsidiaries must remain outstanding the resulting financial structure may be difficult to work out on a clean-cut basis and the resulting set-up be complex to the point of resembling a crazy patchwork quilt. Such complex capital structures are fortunately much less common among industrial mergers than among consolidations of railways or public utilities.

Simplicity of capital structure is greatly to be desired for many reasons. Perhaps the most potent one is that it tends to establish a better market for the merger's securities. Whether an investor owns common or preferred stock or bonds he generally favors those that have as few securities ahead of them as possible.

Thus if he leans toward bonds he prefers those which have no underlying obligations of the subsidiary operating companies ahead of them. If he likes to have his money in preferred stocks he would rather that there be no bonds of any kind with prior claim on earnings and assets. And best of all in the

minds of a considerable number of investors in recent years is the common stock of companies having no bonds or preferred. Thus it is that such a leader as the United States Steel Corporation has decided to retire its entire bonded indebtedness. In recent years, many mergers, as a result of the predominant desire of investors for common stocks, have retired bonds before they matured and have called large amounts of preferred stocks.

There is another potent reason for confining the capitalization to as few as possible issues—especially when a merger is small or of only medium size. Obviously the fewer kinds of securities there are the more of a kind there will be. That means usually that they will be more widely held, in greater demand and as a result will enjoy a better market. Marketability is a highly desirable attribute in the minds of most investors.

The financial plan of a corporation includes a decision as to the kind and amounts of the various securities to be issued as well as the rates of interest and dividends to be paid on bonds, notes and preferred stocks.

Many and complex conditions dictate what particular plan will be best in any case. These are based largely on experience. While no definite rules can be laid down which would be subscribed to by all bankers and business men, and while different men might work out plans differing in details for any given situation, there is apt to be a striking basic similarity in the plans different bankers would propose.

The outstanding points which govern the financial plan are:

1. The fashions in securities at the time the merger is formed.

Investment fashions change just as radically, if not as a rule so often, as fashions in women's clothes. During the past few years the investing public has favored common stocks, at other periods it has gone in for preferred stocks, and at others for bonds.

If the properties are to be paid for by an exchange of stock, no part of the purchase price being cash, and if the merger has all of the working capital it needs, there may be no reason for a bond issue.

But if cash is needed for either of these purposes, it is often necessary to issue bonds, as usually providing the surest and easiest way to get cash. That varies, of course, with the conditions in security markets and with the changing trends in the investment fashions. There are times when the public is avid for ownership of industrial common stocks. In such times the market for bonds is usually dull and money can be secured cheaply and readily by offering the public a chance to buy stocks.

At other times, the public fancy favors preferred stocks as being safer. Then the capital structure may well be made up of both preferred and common with no bonds.

Again, when the public is in a conservative humor, as is commonly the case after a violent or protracted decline in market prices for stocks, it may shy away entirely from common stocks, demand a high dividend rate on any preferred that it buys,

but snap eagerly at well-secured bond issues, especially those which have a feature enabling them to be converted into common stock. The bond gives a high degree of security while the conversion privilege enables the bondholder to profit if the company turns out to be notably successful.

In such a market, and barring all other conditions except the need of the merger for cash, the financial structure could conceivably consist only of bonds and common stocks. It is, however, not the most usual set-up—usually when there are bonds we also find preferred stocks. It is more usual to find the set-up consisting of preferred and common stock. Of the thirty-one mergers listed in the table on page 135, twelve, or 38.7 per cent, are in this category. Only three have no securities other than bonds and common stock. Thirteen in all have funded debt either of their own or subsidiary companies, while twenty-three, or 74 per cent, have preferred stocks.

It is interesting to see that six of these mergers have only common stock—namely, General Foods Corporation, The Borden Company, Anaconda Copper Mining Company, Air Reduction Company, Texas Corporation and the Union Carbide & Carbon Corporation.

Developments during the life of the merger frequently dictate changes in the capital structure, but in this discussion we are considering only the original set-up.

2. The type of clientele of the investment banker who handles the financing is an important factor.

Certain banking houses are known as specialists in certain types of securities and so attract customers who favor what they sell. Thus at one and the same time, of three different banking firms, one may have a conservative clientele of bond buyers, another's customers may stick pretty closely to preferred stocks and the third may cater to the more speculatively inclined who favor common stocks.

The banker who handles the merger will naturally favor the issuance of the type of security which his customers prefer.

3. The stipulations of the old owners of the merging companies sometimes affect the financial plan.

As we have seen, if they will sell only for cash, the merger will usually have to issue the type of security which its bankers can sell.

Sometimes, the sellers are willing to take common stocks, especially if they happen to be young men and are going to be active in the management of the merger.

If they are to draw out of the business and are highly conservative as to their investments and doubtful of the ability of the management to make a success of the merger, they may demand payment in bonds or preferred stocks. Andrew Carnegie demanded payment in full for his Carnegie Steel Company in bonds of the newly formed United States Steel Corporation.

If for reasons which will be brought out later it seems undesirable to put out a bond issue, such a seller may demand that he be paid in preferred

stock, and so determine to that extent the capital plan of the new merger.

4. Even where bonds seem at first to be indicated as a part of the financial set-up, other conditions may make them impossible or undesirable.

It is, of course, evident that, for bonds to be worth the paper they are printed on, there must be sufficient in the way of readily saleable assets behind them. Many highly successful businesses do not have such assets. They may have a negligible amount in assets and yet have great earning power.

Again, the balance sheet may show a large investment in plant, and yet a bond issue be undesirable. For one thing a plant may be poorly located relative to other concerns in the industry. Thus a paper mill building would usually be much more easily saleable in a paper manufacturing center than in a town where it had been the only paper producer.

Again, there is a finely equipped but now idle plant owned by the bondholders, which so far has proved to be unsaleable because no one seems to want to go into a business which is in a decline.

Then, too, a plant may be too expensive to command a wide market in the event of forced liquidation. Thus a steel mill or a chemical plant might well cost $25,000,000 or more to replace, yet be hard to sell for the reason that there are only a half dozen concerns in the country who could afford to buy it because of its very value. The most readily saleable plant is the small and comparatively inexpensive one in an industry where there are many potential

buyers. Such might be a flour mill, a bakery or a creamery.

5. Bonds should be issued only when the earnings are certain to be large and regular. Many of the early "trusts" went on the rocks because they had obligated themselves to pay far too much in bond interest. Bond interest must be paid promptly and regularly when due or the company runs the serious risk of being thrown into bankruptcy or at best a receivership.

Frequently fixed charges for interest constitute too heavy a drain on earnings and make it impossible for a company to build from within by plowing back present earnings in order to increase profits in the future. This may be particularly important for a merger, which as we have seen hopes to be able greatly to reduce ultimate costs by spending larger amounts for betterments of one sort or another than the member companies could as independents.

On the other hand, if the earnings promise to be unusually large it is to the interest of the common stockholders to secure as large a part as possible of the capital at the low rate that bonds commonly carry, thus leaving more for the common stockholders due to the fact that there is less common stock outstanding than there would have to be if there were no bonds. That is called "trading on the equity"—a phrase and a procedure which have had quite a play in recent years.

The unescapable necessity of paying interest on bonds dictates that the expected earnings be not only adequate but regular. A bad year may result

in a disastrous default. It is quite generally agreed that unless the history of the merging companies shows a high degree of stability in earnings, a bond issue may be disastrous to the merger, its stockholders and the investors in the bonds. Earnings of at least twice the total bond interest charges should be certain.

In fact, some capable students and practitioners in the realms both of finance and of industry hold that no industrial company has any business to issue bonds, both because of the uncertainty as to future stability of earnings in most industries and because of the difficulty often encountered in disposing of any plant for a fair price at a forced sale.

Like all general statements that is probably too sweeping. There are many successful industrial companies that have bonds yet it is indubitable that in times when money can be secured by selling stock, the trend seems to be away from bonds.

Even though a bond issue were to be perfectly proper and feasible, if the merger has no immediate need for cash it is usually best to refrain from issuing them at the start but rather to hold that possibility in reserve for contingencies when cash may be needed for expansion, improvements or whatnot.

6. If earnings promise to be somewhat irregular but large enough on the average over a period of years to cover preferred stock dividends, it is much sounder to use preferred stock rather than bonds.

7. If it appears that net earnings are apt to be both irregular and uncertain in amount, bonds and preferred stocks have no proper place in the finan-

cial structure. Common stock is the only possible security if the set-up is to be sound.

The foregoing considerations governing the types of securities to be included in the financial plan boil down essentially to two principal ones:

1. The current fashion in securities; i.e., what can be most easily sold to investors.
2. The peculiarities of the business as to assets and earnings.

In previous chapters we have seen that the soundest thinkers among business men and bankers now agree that for an industrial company, whether a merger or not, earnings are of more importance than assets. They look upon a business as primarily a profit making machine rather than a collection of hockable brick, mortar and machinery. They are interested in it as a going business that will continue to go, not as something that may have to be put on the auction block.

It is usually not at all difficult to determine quite closely what the net earnings of a proposed merger will be, based upon the great amount of experience we have had with mergers since the World War. Estimates of earnings today are, therefore, quite accurate especially compared with the estimates made by the promoters of the trusts that came into being around the beginning of this century. They commonly were badly off, sometimes through lack of knowledge, sometimes because of unbridled optimism. Many of those early mergers made smaller profits than the aggregate profits of the constituent independent companies.

Today, with wide experience and accurate statistics, there is no reason why earnings cannot be quite closely determined in advance.

But that done, we enter what is admittedly more or less the realm of guesswork.

The next and a highly important question bearing on the capital structure is: What ratio should these prospective earnings bear to the capitalization in common stock?

It goes without saying that earnings can hardly be sensibly capitalized at a ratio lower than that used in determining what the merger shall pay for the properties. With that as a bottom limit, there seems at times to be little in the way of a maximum ratio lower than the sky. Here, too, the principal guide is the current fashion for securities. At times investors decline to pay more than eight or ten times earnings—sometimes they even insist that the company earn as much as 20 per cent or more.

Again, when the future seems bright, when people get the idea that we are really in a new economic era and that there can never again be a business depression, they will cheerfully and unquestioningly pay thirty or forty times earnings.

Here, again, the best judge as to the proper amount of common stock is the seasoned and widely experienced investment banker, for he knows not only trends in security fashions but the limits beyond which it is undesirable or downright unsafe to go, regardless of fashion.

So much for common stock. If for any reason it seems desirable to have the capital structure include

bonds or preferred stocks or both, there are somewhat more definite guides as to the amounts to be issued.

Mortgage bonds, it is to be remembered, are first liens on all of the assets of the business. They come before the claims of all other creditors except those for wages and taxes. Preferred stocks, however, are not liens but evidences of ownership—although of ownership preferred as to assets after all creditors' claims have been settled in full.

Thus bonds are commonly considered safe if there are from two to two and a half times as much assets as bonds—providing those assets are of a kind that can be readily realized upon at forced sale for close to their real value. We have discussed earlier in this chapter the considerations that determine how saleable fixed assets such as plants are.

But since both bonds and all creditors' claims come ahead of the preferred stock, reasonable safety for preferred stockholders in the event of forced liquidation demands that there be assets equal to from three to four and a half times the par value of the preferred. But, if there be any doubt as to the ability to sell the assets advantageously, investment bankers and their clients will demand a greater factor of safety.

The maximum of bonds and preferred stocks to be issued may be limited by the earnings of the proposed merger as well as by the amount of its assets. There can be nothing approaching a definite rule that would apply generally to all types of industrial mergers. If the earnings promise to be

quite stable the ratio of earnings to bond interest or preferred dividends could safely be somewhat lower than if the earnings are not so stable and regular. Roughly about the same ratios predominate as for assets.

For the sake of simplicity, we have spoken of "preferred stock" as though it were some quite definite thing. Actually there are probably nearly as many kinds of preferred stocks as there are companies that have them in their financial structures.

A preferred stock may or may not be preferred as to assets, may or may not be preferred as to earnings. Its dividends may or may not be cumulative. It may or may not have voting power even when dividends are passed. It may be designated by a number as "1st Preferred," "2nd Preferred" and so on. It may be called "Class A," "prior preference," "preference," or "prior preferred stock." It may or may not be callable or convertible. These variations may arise out of the complication of the capital structures of the merging units, from considerations arising in the negotiation of the purchase of companies, out of exigencies in the security markets or otherwise.

In the same way, there are wide variations in the provisions as to bonds.

As this is not a handbook on general corporation finance, it would be out of place to describe all possible types of securities even if that were possible. New types are being developed almost from day to day, designed to fit peculiar corporate conditions as well as to appeal to investors of different tastes.

Our purpose has been merely to sketch in broad strokes the basic principles which determine the financial structure of an industrial merger, for the benefit of business men who contemplate joining a merger, so that they may have certain guides by which to test the soundness of the proposals made by the officers of the merger to which they contemplate selling, or by the promoters of some brand new consolidation.

	Capitalization						Number of Subsidiaries				
Company	Funded Debt	Preferred Stock	Par Value	Common Stock	Par Value	All Assets Owned	Entire Stock Owned	Majority Stock Owned	Minority (3) Stock Owned	Indeterminable	Total
General Motors Corp....	.....	$134,494,500	$100	$442,606,400	$ 25	14	61	7			82
General Foods Corp.....	.....	.....	....	4,682,736 Shs.	No Par	2	15				17
Standard Brands, Inc...	.....	181,482 Shs.	$7 No Par	12,533,004 Shs.	No Par			4			4
The Borden Company...	.....	.....	....	$ 62,588,750	$ 50	71 Units	(1)				71 (1)
Hahn Dept. Stores, Inc.	.....	$ 25,000,000	$100	1,331,969 Shs.	No Par		25				25
Flour Mills of Amer., Inc.	$ 3,500,000	25,000 Shs.	$8 No Par	302,275 Shs.	No Par		4				4
United Wall.....	.....	37,000 Shs.	$7 No Par								
Paper Factories, Inc.....	$ 2,138,000	$ 700,000	$100	201,490 Shs.	No Par	4					4
Anaconda Cop. Min. Co.	.....	.....	....	$373,756,950	$ 50	11	8	11			30 (2
American Writing Paper Co., Inc.	$ 6,076,000	89,268 Shs.	$6 No Par	197,254 Shs.	No Par	14					14
American Can Co.....	.....	$ 41,233,300	$100	$ 61,847,950	$ 25	1	3		1		5
Continental Can Co., Inc.	.....	$ 4,932,000	$100	1,459,991 Shs.	No Par	7	4			5	16
U. S. Steel Corp.....	(4)	$360,281,100	$100	$711,623,500	$100		27	3		24	54 (5)
Bethlehem Steel Corp....	$198,857,058 (6)	$100,000,000	$100	$180,000,000	$100	53 Units		9 Mining	4 Mining		66
Houdaille-Hershey Corp.	.....	173,637 Shs.	$2.50 No Par	260,863 Shs.	No Par		3	2			5
Chrysler Corp.....	$ 59,937,000 (7)	.....	....	4,407,475 Shs.	No Par		23				23
Allied Chemical and Dye Corp.	.....	$ 39,284,900	$100	2,178,109 Shs.	No Par		7				7
American Tobacco Co....	$ 1,111,350	$ 52,699,700	$100	$ 97,645,850	$ 50		9	4			13
General Electric Co.....	$ 2,047,000	$ 42,929,635	$ 10	7,211,842 Shs.	No Par	6	4	7	3		20
National Biscuit Co.....	.....	$ 24,804,500	$100	$ 55,238,000	$ 25		4	2		4	10
Radio Corp.	.....	$ 19,779,870	$ 50	1,155,400 Shs.	No Pa	4	1	5	1	3	14
Safeway Stores, Inc.....		$ 8,157,000	$100	568,315 Shs.	No Pa		17				17
Loew's Inc.....	$ 13,501,000	150,000 Shs.	$6.50 No Par	1,334,453 Shs.			57	49	20		126
Air Reduction Co., Inc...	.....	.....	....	696,793 Shs.		5	19	2		10	38
Allis-Chalmers Mfg. Co.	$ 15,000,000	.....	....	$ 26,000,000	$100	4				2	6
Johns-Manville Corp.....	$ 1,750,000 (7)	$ 7,500,000	$100	750,000 Shs.	No Par		10	1		1	12
Gulf Oil Corp. of Penn.	$ 65,904,000	.....	....	$112,623,025	$ 25		20				20
Texas Corporation.....	.....	.....	....	$211,083,850	$ 25		28				28
Union Carbide and Carbon Corp.....	.....	.....	....	2,742,072 Shs.	No Par		32				32
Eastman Kodak Co.....	.....	$ 6,165,700	$100	2,056,219 Shs.	No Par		9				9 (8)
Corn Products Refining Co.	$ 1,822,000	$ 25,000,000	$100	$ 63,250,000	$ 25		9				9
Remington Rand, Inc....	$ 23,411,000	$ 19,466,090	$100	1,344,043 Shs.	No Par	4	7				11
						76 124 U.	406	106	31	49	792

(1) Approximately 100 units contracted for or acquired in year and one-half ended July 31, 1929.
(2) Operates also through leases.
(3) Sometimes carried on balance sheet under Investments.
(4) All U. S. Steel funded debt called this year of $136,751,000 of subsidiary bonds outstanding August, 1929, $73,000,000 are non-callable.
(5) Railroads controlled by or in interest of U. S. Steel Corporation.
(6) Including subsidiary funded debt.
(7) Subsidiary funded debt.
(8) Also owns a large number of small operating concerns.

CHAPTER VIII

Management Problems a Merger Must Solve

COMMONLY the first and often the most important problem a merger must solve has to do with the relative jobs and ranks of the executives.

If the merger falls heir to a considerable number of the old owners of the formerly independent enterprises the problem nearly always turns out to be a tough one. As owners they were undisputed bosses in their own spheres of influence. They were big toads. Their word was law and they brooked no questioning.

Then a dozen or so of such autocrats are gathered into a single company. Only one of them can be boss. Who shall it be? Many a merger has failed of consummation because this question came up too soon. And by the same token many a merger has failed for years to make the profits it should because dissension over the question of precedence dragged out the "hell period" for years when it should have been ironed out in a few months.

When an individual company or a small group is taken in by a large and established merger, this particular problem is usually easily solved. In fact, it may not arise at all. But when several independents get together to form a brand new merger the problem is usually acute and painful.

In some few cases there is one dominating personality, generally a recognized leader in the industry, who stands out so preëminently that in spite of personal ambitions and jealousies no other has a chance to take the reins. Fortunate is the merger which acquires such a man.

Again sometimes the best man is so diplomatic that he gets himself into the driver's seat by climbing over the tailboard. That happened a few years ago in a newly formed merger of more than average size. A battle royal had developed over precedence, and for a while it looked as though the merger might have to dissolve into its constituent elements. Finally, however, the really big man arose and said in effect to the presidents of the other merging companies:

"Gentlemen. Our industry's only hope is in this merger. Together we can cut costs and stabilize prices. We will not only survive, but taste profits for the first time in years. We must go ahead with this merger. As a starter let me say that I will take any job in our new company that you choose to give me. Or, if you wish I will withdraw entirely and become a mere stockholder and director. We all know each other's capabilities pretty well. Let's forget our silly vanities and select the best man for each job."

He was made president, and the selection was justified by the later success of the business. The others fitted themselves into subordinate positions. One whose forte was finance became treasurer. Another who had always, in his own business, given

a disproportionate amount of his time as president to sales, became vice president in charge of distribution and, relieved of other duties, made more of a success in selling than he had ever made before. A third, who had been something of a "shirt-sleeves president," took over the direction of production and with no distractions from other phases of the business, secured most of the production economies which had been forecast for the merger. The group which had formerly been at sword's points over silly considerations of personal prestige became a happy and profit making business family.

Usually, if a preliminary working compromise can be effected, the problem works itself out. In a year or more the man in the organization best fitted for leadership is practically certain to make himself felt and rise to the top. In the same way others will rise, sink, or drift into the niches they can best fill and the incompetents will either eliminate themselves, or by reason of their proved incapacity, work themselves into a position where they are easily slipped out with a judicious use of skids. Such a situation, however, has its disadvantages and usually results in a long drawn out "hell period" which may prove ultimately disastrous.

If the new merger is one in which banking help is required, the banker is more than apt to prove a strong influence in ironing out conflicts of interest and to decide soundly who shall be who in the new enterprise.

At bottom most of the personal striving for precedence among merging competitors usually turns out

to be ridiculously childish. In one case a man refused to sell out to a merger that had no place for him personally in its organization, because, he said, "as a retired business man my prestige will suffer in my philanthropic and other activities in the public interest. To be most effective I must be known as an active business man."

Another claimed that to become a mere vice president of the merger instead of president of a smaller concern would impair the social standing of his family and himself. "I would never dare show my face in my clubs," he all but sobbed.

Most mergers have as an important object the reduction of cost. In Chapter V we have seen how material these savings can be. A large part of them obviously come from eliminating excess personnel both of executives and of the rank and file.

There is considerable difference of opinion as to the method to be pursued in reducing the payroll as well as to the best time to do it.

It may seem best to agree upon a somewhat drastic pruning of the personnel during the negotiations leading to the merger and before the merger is actually consummated. There is this, at least, to be said for this plan: it clears the stage and reduces the problems which face the fledgling merger in its early days—when there are problems enough to be solved without the complications that come from selecting the heads that are to be chopped off.

On the other hand, any attempt to determine who shall go and who shall stay may, when a proposed merger is being discussed, result in all negotiations

going on the rocks. It calls for excellent judgment, the ability to size up the peculiarities of the personalities involved and of the various ramifications of the situation, to say nothing of able generalship and diplomacy.

There is even some difference of opinion as to the policy to be followed in hiring and firing after the merger is formed. We happen to know two men, both of whom were called to the presidency of mergers in their respective industries at about the same time, roughly, ten years ago. One of them followed the plan of retaining all of the old executives who had promise of being of value—which, in this instance, was most of them. He carefully explained the policies of the new merger and devoted himself almost night and day to securing team play and a smoothly functioning organization. He succeeded, and the merger he still heads is notably successful as regards both profits and services to the community. He has been able to raise wages all along the line, yet his customers pay only about 60 per cent as much for the merger's product as when it was formed. It would seem that this man's policy of keeping the old executives and educating them in new ways had proved itself sound. Yet he maintains stoutly that if he had it to do over, he would fire every executive and start with a completely fresh staff.

The other man followed this plan. He let every executive in the merged companies go and filled their places with younger men from within the com-

pany where promising material was in evidence, or went outside for new blood.

This merger, also, is most successful. Yet he says that if he were faced with the same conditions again, he would use the other method. The answer is, doubtless, that either plan has its faults and that no matter what is done there are bound to be troubles in getting the management personnel whipped into a smoothly working machine.

A notable instance of the kind of tact that is effective in getting merged competitors to work smoothly together can be taken from the early history of the old American Radiator Company, which originally consisted of a merger of four competing radiator manufacturers. Clarence M. Woolley was among the prominent men of the industry who negotiated and effected the merger. At the start there was evident a certain amount of feeling, not in this case over personal prestige, but over the relative prominence to be given the various products and trade-marks. With men who have built up businesses, the feeling of pride in their product may be every bit at strong as over personal precedence.

Mr. Woolley sensed this feeling and met the problem by the simple expedient of listing the products of his own company last in the new catalogue of the merger's products. This indication that he had no intention of "hogging" anything connected with the business had as much as anything, in his opinion, to do with starting the merger off free from internal friction. Mr. Woolley, by the way, is still active in the business, being Chairman of the Board of the

combined American Radiator & Standard Sanitary Corporation.

As a rule no exceedingly capable executives will be let out of the merger until every effort has been made to fit them in somewhere, for mergers as a rule are covetous of the best possible talent. But sometimes in the process of consolidating operations and eliminating duplication of executive personnel, in striving to achieve administrative economies, an able man must be let out in order to keep a still abler one. In certain lines of business that may cause the merger much later trouble, especially if the industry is one where selling is highly important and where the investment in plant is comparatively small.

It is, for example, easy to set up in the dairy products industry, the baking industry, or any which is essentially local and dependent primarily on the good will of the retail trade, with comparatively small capital provided the new business is headed by a man with a loyal local following. This has often happened in many such industries. A sales manager, say, or even the president of one of the merged companies is let out. Disgruntled and revengeful, he secures the small amount of capital needed, sets up in business, plays up the "not in a trust" motif, perhaps takes with him a large number of salesmen or even executives that the merger would like to retain, and raises havoc with the merger generally.

The merger may find its business seriously cut into, and in order to hold its own may be forced

into a price war that eats up the anticipated increase in net profits from economies and perhaps even causes the profits to fall below what they were in total for the merged companies.

Because so large a part, at least of the immediate, increase in profits from merging is generally realized to result from reduction in duplication of personnel, it is common for a serious falling off in employee morale to result as soon as a merger is announced or even rumored. Everyone senses the proximity of the ax which he fears may sever him from the payroll.

Clerks, department heads, and even the executives fairly well up the line brood over their fears, on company time, with serious effect on their work.

Playing politics becomes the principal working hour effort. Everyone is out to make a place for himself, not usually by harder and better work, but by discrediting his fellows who he fancies are competitors for the remaining jobs. Some of the employees start looking for new jobs and many find and take them, crippling or at least hampering the new merger.

In one instance a number of, let us say, dairy product companies merged in order to combat more effectively the large and well-established company in that field which was itself a merger formed a number of years before.

A large percentage of the salesmen-drivers of the new merger became panic-stricken over the possibility of losing their jobs and went over to the old merger, which was only too glad to take most of

them on. Their fear was, of course, unreasonable and unwarranted for they were essential to the new merger and the jobs of all capable ones were perfectly safe. But their defection made it necessary for the fledgling merger to secure and train an almost completely new selling and delivering staff and it was months before its operations got out of the red.

There is not at present as much public antagonism to consolidations, or to "big" business in any form, as there was during the trust busting days of a few years ago. This is probably due chiefly to the fact that modern mergers have not boosted prices but have, on the contrary, often lowered them and improved both the product and the service. Also, mergers have found that it pays to take the public into their confidence and to maintain good public relations in many ways.

But in certain parts of the country and among certain strata of its population there is still a feeling of distrust for mere size. It may be active or merely dormant, but it is undeniably there.

Some ultimate consumers prefer to be on a personal basis with their grocer, baker and dairyman and hence will give their trade to the small local proprietor rather than to the store or representative of the corporation which they visualize as some sort of a slimy Wall Street monster with tentacles, glaring eyes and a wicked, menacing beak.

This feeling is more or less common even with the heads of some medium-sized business. They like to know the president of the concern from which

they buy materials, supplies and equipment for their stores or factories. Other things being equal, their trade goes to the small, non-merger company.

This is not so general as to be now or ever a menace to the merger movement as a whole. But the feeling does exist and may in cases be stirred up with serious results.

Much of this more or less latent antagonism is aroused to active manifestation by discharged employees, and some of it no doubt by employees who fear they may be discharged. Commonly it expresses itself in what amounts to a silent boycott of the merger.

To quiet those who must be let out, some mergers go to great lengths to give everyone a fair notice and all of the assistance possible in getting located anew. It pays distinctly to eliminate all reason for ex-employees having a grudge on the ground of ruthless firing.

When a merger, or the acquisition of one company by another, is first announced it is the part of wisdom to be open and aboveboard with the employees and tell them either openly or by private personal interview just what they can expect. Properly handled this dispels the fears of those who have nothing to fear. Also, if a clean-cut statement is made as to just what the plans are for eliminating duplication of functions and positions and the employees are told that those who remain will be those whose work and general attitude are the best, the ensuing rivalry can be of direct and real value to the merger during its trying early days.

Some mergers have found that it pays to take the public generally into their confidence through paid advertising, statements to the press by officers and by other publicity channels. They tell frankly the why and wherefore of the merger, what it hopes to achieve, how it should benefit its consumers, employees and stockholders and in general what the policies will be.

In the effort to secure a friendly public opinion some mergers, especially those dealing directly with the consumer, have followed the lead of certain public utility companies and urged their customers to invest in the merger's securities. This is based on the natural assumption that the part owner of a company will hardly be much impressed by anti-trust propaganda and certainly will not enter into a campaign to badger and prosecute it, and further that he will naturally patronize his own company.

That is all obvious and true. But it does not take into account that in a declining security market the customer who has been urged to buy, and has bought, securities is not likely to remain friendly. Such investors as a rule take fright easily and are prone to sell out their small odd-lot holdings at a loss. If they have been assured by the management that they were investing in a sound security they are apt to conclude, not knowing much about market ups and downs, that they have been swindled and made the prey of the unscrupulous octopus.

So, while it is undeniably advantageous for a merger's securities to be widely distributed, it is at least open to question whether it is wise for the

merger to be active in urging stock purchases upon its customers. And this applies equally to selling stock to employees, as several mergers discovered during the stock market decline in the fall of 1929.

The division of duties, the inside arrangement of the organization and the laying down of lines of authority present important and often difficult problems in a merger. For example, it is usual in an independent manufacturing company to have a rather clean-cut line of cleavage between the functions of manufacturing and of selling. A production superintendent is commonly czar of the factory and a sales manager has equal authority in distribution. Presumably they confer for the good of the business, but usually the two departments are wholly separate and distinct.

Many mergers find the same policy to be desirable although as a rule the general management sees to it that there is a sufficiently close tie-up between the two departments to enable both to function to the best advantage.

However, there is a noticeable trend along novel lines in concerns whose products are in the style category. For example, take the case of a wholesale house which has acquired by the merger route a dozen or so large factories making goods exclusively for sale by the wholesaler.

This concern has put each factory directly under the control of the manager of the merchandising department that has to sell its output. He does not, in fact, devote much of his time to the factory. However, one of his assistants actually operates the

manufacturing end under orders from the merchandise manager.

A high officer of the company explains this seemingly radical policy in a recent issue of *Factory and Industrial Management,* as follows:

"We have tried having a separate manufacturing organization. Ten years ago it worked reasonably well, with a general superintendent in charge of all our plants and directly responsible to the general management. But we had to quit it. The change in the way business is done in our line was too violent for manufacturing executives to meet, we found. We have occasionally since then tried putting top-notch production men with top-notch records in charge of individual plants in our group, but every time we have had to give it up. I think it is safe to say now that we will not operate any of our plants except under our present plan, until merchandising undergoes a drastic change—and we see no sign of such a change.

"Style has become the predominant note in our line of business. The merchandising man is keenly alert to these changes. With a factory as one of his responsibilities, he shifts overnight to a new style of product that he thinks will sell better than the old.

"A man whose outlook on a factory is typically production-minded does not shift so quickly. He is not so good an opportunist. He is more concerned with long-term planning; and planning is one luxury that we can't afford nowadays.

"It's even worse with a general superintendent over all the plants. That slows up the process of

change just that much more, as well as adding to the overhead. Even the most efficient production executive in our lines cannot save as much money by better manufacturing policies and methods as he will cost us by turning out badly styled goods for three days longer than he ought to. There, in brief, is why we have each of our factories directly under the merchandise sales manager who has to sell its output. Theoretically it may be wrong, but actually it makes us money."

In the larger mergers with ramifications over nearly the entire United States and often even world-wide in scope, the method of organizing the management function is not only highly important but often quite puzzling.

Theoretically, there are three ways of managing such a merger:

First, by centralized control and operation.

Second, by decentralized or local control and operation.

Third, by centralized control and decentralized operation.

The first and second plans are more theoretical than practical and even where one or the other seems superficially to be the method used, by digging deeply into the facts it becomes apparent that there is a strong element of the other.

Although a merger may have a general sales manager in the central office, there are nearly always found to be subordinate sales executives in charge either of geographical divisions or of certain products. And so too with the concern which puts one

man in general charge of production. He may determine general policies and methods but under him there are bound to be men who are responsible directly for the production of the individual factories.

On the other hand, if each merged concern is on the surface operated as an individual company, there is a central office where major policies are determined either with or without consultation.

Between the two theoretical diametric extremes of complete centralization and complete decentralization there is found, in modern mergers, nearly every possible degree of differentiation.

A most important problem that must be faced and solved by the management is just where the best possible balance between these extremes shall be struck, considering all of the conditions peculiar to that merger.

The General Motors Corporation has worked out a plan for centralized control and decentralized operation and responsibility that so far has worked admirably. Each of its divisions is in effect a completely self-contained business under the direct management of a general manager who is responsible for engineering, purchasing, production, sales and financial control. Yet there is still a measure of central control exerted by the officers of the parent company.

The philosophy and the actual working of the General Motors line-up is comprehensively described by Donaldson Brown, Vice President of General Motors, in a paper delivered before the

American Management Association. Its application is so wide that it is well worth study by anyone, whether connected with a merger or not.

"The Board of Directors," says Mr. Brown, "has two sub-committees; a Finance Committee responsible for general financial policies, and an Executive Committee responsible for operating policies.

"The Finance Committee includes men or large affairs identified with banking and with big business, apart from General Motors, while the Executive Committee is composed of men giving all of their time to the affairs of General Motors. In a limited sense the Executive Committee is subject to the Finance Committee in that operations are dependent upon financial policies. At the same time, financial policies must be maintained so that operations will not be deprived of any legitimate development. Cooperation, as between these two committees, is furthered by the fact of common membership on the part of several individuals.

"Obviously, it is humanly and physically impossible for the Executive Committee of General Motors to maintain the same kind of intimate contact with the details of its business as would be practicable in the case of a very much less diversified business. Still the responsibility to stockholders is exactly the same and the proper organization of control has been forced by absolute necessity. Otherwise, the business were better split up into various units with separate ownership, even at the sacrifice of the great advantages of the existing combination, so that the stockholders of each unit

respectively could elect a Board of Directors capable of assuming the usual responsibilities. Let us examine, first, the general way in which the separate units of the Corporation are constituted.

"Each one of these operating units, known as divisions, is entirely self-contained, with a general manager and complete jurisdiction and responsibility established.

"There is never any conflict of jurisdiction, with respect to capital invested. Where any given plant produces a component entering into the finished product of just one of our divisions, it is deemed proper, unless the manufacture is of a highly specialized character, that the investment in that plant and its operation be placed under the jurisdiction of the consuming division. Generally speaking, where the product of a given plant enters into the product of two or more of our divisions, it is deemed desirable to place the investment in such a plant and the full responsibility for its operation under the jurisdiction of a separately organized division. It is thus that our numerous parts and accessory divisions derive their separate entity.

"Apart from certain distinct units embraced in the Fisher Body operations, we have fifteen divisions manufacturing components and accessories, such as ignition systems, bearings, gears, etc. These divisions are grouped together under the general guidance of a vice president who is a member of the Executive Committee of General Motors.

"All of these divisions are selling product to our car divisions, with the exception of one that is em-

braced in the group, which manufactures Frigidaires and farm lighting units. Also these divisions almost without exception sell product outside.

"The question of pricing product from one division to another is of great importance. Unless a true competitive situation is preserved, as to prices, there is no basis upon which the performance of the divisions can be measured. No division is required absolutely to purchase product from another division. In their interrelation they are encouraged to deal just as they would with outsiders. The independent purchaser that is buying product from any of our divisions is assured that prices to it are exactly in line with prices charged our own car divisions. Where there are no substantial sales outside, such as would establish a competitive basis, the buying division determines the competitive picture—at times partial requirements are actually purchased from outside sources so as to perfect the competitive situation.

"In the Fisher Body group are included separate and distinct units supplying materials such as lumber, glass, hardware, etc., for body construction. The interrelation of these units with the final body manufacture is exactly the same as that between the other divisions which I have described.

"There are five automobile divisions in General Motors operating in the United States, each occupying a position in a distinct price class in the industry. There is charged to each the total investment in plants and other assets over which it has complete jurisdiction.

"In addition there is a separate division handling the assembly and sale of all cars in Canada; and an export group handling the sale of all cars in other foreign countries. This latter group has charge of assembly, as well, where cars are assembled abroad.

"With the segregation of General Motors into separate businesses of distinct classification we are in position to compare the performance of various divisions respectively with competition in the same line. Thus we can gauge the over-all effectiveness of management in each case. By the use of suitable statistics and contact with the management of the various divisions, the president of the corporation and central group executives are able to detect instances of faulty control and to bring about the correction of a recognized condition by way of intelligent suggestion. The executive committee is able to deal with operating policies in respect to any division with an understanding of the characteristics of the particular business and the position of the division in its field of competition. This type of organization as applied to big business lends assistance to a high degree of centralized control, while at the same time it affords an opportunity of fixing responsibilities upon the administrative management on a clear-cut basis upon which they can be held accountable for results.

"As a general proposition, I should say that in any business of considerable size and diversification, capable of being subdivided into units having the characteristics which I have described as pertaining to General Motors' divisions, such segregation is

deserving of the most serious consideration. If the advantages of such a type of organization are to be enjoyed fully, it is absolutely essential that each unit be constituted so that it represent a self-contained business enterprise. The capital placed under its jurisdiction must be identified definitely with its own business and no other; and prices at which its products are sold must be based upon actual competitive values. Otherwise there is no tangible basis upon which the general effectiveness of the direct management can be gauged reliably.

"This scheme of organization is usually referred to as the decentralized type. Opposed to this is the centralized type of organization, made up of functional departments; with an executive in charge of all manufacturing operations, another in charge of all sales, and with central purchasing and engineering departments. As to any of these functional activities it is difficult for anyone not in constant contact to judge the efficiency of performance even though he might have a specialized knowledge of the particular type of activity.

"With accurate accounting practices and painstaking analyses the manufacturing cost of a given component, or the complete product of manufacture, at times may be compared with the price at which a similar thing can be purchased elsewhere. However, it is very rare that a comparison can be had with the cost of manufacture elsewhere.

"Also it is impossible to arrive at a conclusive comparison of sales effectiveness and efficiency. Unrecognized inefficiency in manufacture may throw

an impossible task upon a very efficient sales department. On the other hand an inefficient sales department may make it impossible to capitalize a highly economical manufactured product. In any event, general managership is needed. This is essential, not only to gain proper coordination of functional activities, but from the standpoint of having some one in sufficiently close touch with details as to be competent to size up the effectiveness and efficiency of departmental management.

"In the days of small business, corporations or privately owned businesses were managed by men who had a detailed knowledge of all the functional phases of the business. Department heads, and even those below had intimate contact with the general problems of the business, and gained knowledge in the essentials of general managership. The heads of many large corporations today had their early training in the atmosphere of the small business, and know from experience the character of problems which present themselves down the line and recognize the need and method of coordinating the various activities.

"In the sense in which I am using the phrase, there are still many small businesses. But a large share of the country's manufacturing business today is conducted by huge corporations, brought into being by force of economic development and the opportunity of capitalizing the enormous advantages of large-scale operation. As applied to these there is a comparatively new problem of organization. That problem is to combine the economical advan-

tages of modern business, with as little sacrifice as possible of that intimate control and development of managerial ability that is characteristic of the well managed small business.

"Most of the divisions of General Motors are enormous in themselves, but separately they do not have the complication of products of highly diversified character or type. Operating as separate self-contained businesses, the divisions afford the advantages of concentrated management inherent in the small business. It has been pointed out that, apart from these advantages, this scheme of organization facilitates the exercise of centralized control from the policy standpoint in the case of a corporation constituted as General Motors is.

"Apart from the coordination of activities within each operating division, there are questions of corporation policy having to do with interdivisional relations. There must be no undue conflict, competitively, between the product of one division and that of another. There are certain general policies which, if good for one division, are good for all divisions. There are other questions of policy which must be determined from the standpoint of the corporation as a whole, rather than from the standpoint of any single division.

"Purchases of materials must be conducted in a way so that the full advantages may be enjoyed from the combined requirements of all divisions. Engineering developments of fundamental character must be brought to light and the adaptability determined. Manufacturing methods and policies dem-

onstrated to be advantageous in one place must be considered for adaptation under like conditions elsewhere.

"Similarly as to sales methods and policies. All products sold are advertised directly by the divisions respectively. However, General Motors advertises as an institution. The institutional advertising must be coordinated with the direct product advertising; and the integrity of the corporation's position must be preserved by making sure that the advertising is according to the facts, and in line with the policies of the corporation.

"Serving in the direction of crystallizing the important corporation policies and making them effective, and to facilitate the adaptation of engineering improvements and operating methods, there are various so-called interdivisional relations committees. They have suitable representation from the most important divisions, and are as follows: General Purchasing Committee, General Technical Committee, Works Managers Committee, General Sales Committee, Institutional Advertising Committee.

"These committees meet separately at least once a month. The President of General Motors is a member of each one, and besides, there is at least one other member of the Executive Committee. The work of the committees clears through various central office staff organizations, maintained so as to perfect the flow of information back and forth and to facilitate the orderly consideration of common problems of important policy and procedure.

"The Purchasing Committee deals with questions of general purchasing policy, but, by reason of the

nature of the situation, it directs the actual purchasing arrangements in cases where it is found advantageous to centralize the purchases of materials common to two or more divisions. Such purchases usually are effected by a central staff organization headed by an executive who is secretary of the General Purchasing Committee.

"Similarly, the Institutional Advertising Committee passes upon copy for General Motors institutional advertising. In all other cases, however, the interdivisional relations committees have no actual authority. They are not designed to function as administrative bodies, but rather as a means of providing an opportunity for general discussion of problems of common interest. No one is bound by the expression of opinion by others in meetings of these committees; there is no transfer of responsibility. Where there is a question at issue on the score of corporation policy the President of General Motors makes the decision or refers it to the Executive Committee for its determination. Cases of this kind are rare.

"As a fundamental requisite in the work of coordination, it should be remembered that the bringing of men's minds together in connection with a given problem can always be greatly facilitated through a presentation of the facts. Disagreements fade away in proportion to the degree to which facts may be substituted for opinion. So far as it is practicable the discussions in these committees are predicated upon the display of facts. Questions of policy are clarified; and through the operation of these several committees a means is provided of

gaining a widely diffused knowledge and understanding of corporation policies, and a sympathetic compliance with them as they may bear upon the immediate problems of divisional management.

"The head of each division should be qualified in every way to hold the position of president were its business owned and operated by an independent company. He has all the latitude and authority that normally would go with such a position, being limited only in the direction of policies such as properly would be dealt with by the board of directors or executive committee. In the actual situation such questions of policy are dealt with by the President of General Motors and group executives, facilitated through the operation of the various interdivisional relations committees, reference being had to the Executive Committee of the Corporation when occasion requires."

Quite obviously not all mergers could blindly adopt exactly the plan which has been so successfully used by the General Motors Corporation without change in details and in the relative balance between centralization and decentralization. Yet basically we find that this plan is essentially the one in use by leading mergers in such various fields as copper, steel, food products and retail stores.

There is much to be said for it. When it is possible to continue the merged companies practically as individual enterprises, many of the problems which have been discussed in this chapter never arise and those that do are likely to be more easily solved

CHAPTER IX

Mergers and the Anti-Trust Laws

Note: The authors obviously do not intend this chapter to be a legal treatise but merely an attempt to outline for business men who are not lawyers the outstanding pertinent features of the law as it affects mergers. To cover the situation fully and in detail would require many volumes and even then the reader would not have an entirely certain basis for determining exactly what the courts will hold regarding an existing or proposed merger.

It is to be remembered that each case must be considered in the light of the facts peculiar to it. The courts have so declared on numerous occasions. Therefore, to be safe, the opinion of competent counsel and perhaps of the Department of Justice should be secured on any specific proposed merger or contemplated line of action.

As a presentation of the present status of mergers under the Anti-Trust laws, written by one layman for other laymen, this chapter admirably fills its purpose.

William P. Jeffery
Jeffery & Redmond

IN effect the Sherman Law declares to be illegal, "Every combination in restraint of trade" and it forbids monopolizing or attempting to monopolize any part of interstate or foreign commerce.

The most common criticism of the law in the beginning was that it failed to define specifically what is meant by restraint of trade and what, exactly, constitutes a monopoly. This was left to the

courts to decide. As a result of the changing attitude of the courts, and in some cases, apparently, conflicting opinions, business men have, since the law was passed, been more or less uncertain as to whether what they were doing, or contemplated doing, was legal or illegal. It is sometimes held that Congress drew the law carelessly, and would better have made it specific as to what could and what could not be done lawfully in the formation of mergers and industrial consolidations.

But the best thought now seems to be that Congress showed excellent judgment—that for once at least it did not attempt to foresee the distant future and make its legislation so rigid that it would not fit future conditions as they developed.

The law does not state the economic evils it was designed to forbid, but it is apparent that specific evils were in view and that it was directed against the oppression of consumers by unduly high prices and of competitors by predatory and unscrupulous business methods designed to ruin them.

It was clear to the able lawyers who drew up the law that it would be more conducive to justice and to the proper progress of business not to lay down inflexible rules, but rather to leave to the courts to define and determine just what could and could not be done. Courts are likely to be in close touch with current trends, and in having to do with so complicated a structure as modern business they are able to determine the facts in specific cases and lay down rules which will be to the economic advantage of all concerned.

As will be seen later on in this chapter, the courts, especially in recent years, have generally followed a "rule of reason," not laying down any arbitrary criteria as to what constitutes monopoly, and have in their decisions taken into consideration the intent and the actual business behavior as well as the business and economic effects of those mergers which have been attacked by the government.

It would be difficult to understand the present status of mergers before the law without at least a superficial knowledge of the trend of court decisions since 1890 when the Sherman Law went into effect.

Briefly, there have been four stages, fairly well defined by crucial decisions.

Up to 1904 it was generally held that since the right to acquire and own property had not been interfered with by Congress, the Sherman Law could no more interfere with mergers or combinations as such than it could with the right of a private individual to buy and own property.

This belief was founded upon the decision of the Supreme Court in 1895 having to do with the merging of four independent sugar refineries with the American Sugar Refining Company, with the result of concentrating control of 98 per cent of the sugar refining production in a single company. Partly, it is claimed, because of a technical error on the part of the prosecution the Court held that no violation of the anti-trust law had been shown. In its decision the Court said, "Congress did not attempt [by passing the Sherman Law] to limit and

restrict the rights of corporations created by the states or the citizens of the states in the acquisition, control or disposition of property."

As a result of this ruling, business felt safe in putting through mergers of great size—in many cases controlling close to 100 per cent of the production in an industry. As a result, during the next ten years there was enormous activity in the field of merger promoting.

The next important case involving corporate consolidations to come before the Supreme Court was the Northern Securities case in 1904. Although this was in the railroad field it had a strong influence on industrial mergers. It succeeded in jolting the confidence of the business community for it was almost diametrically opposite to the ruling in the Sugar Refining case on which the great merger movement had been based with a feeling of confidence in the attitude of the courts. The decision indicated clearly that a combination of monopolistic character or in direct restraint of trade could not avoid the penalties of the law by means of a holding company. Some of the language was so broad as to make illegal business transactions which had never until then, nor have since, been considered illegal.

The feeling of uncertainty as to what could be safely done in the way of consolidating business enterprises was enhanced during the next few years by the decisions of the lower courts in the American Tobacco Company and the Standard Oil Company cases, which gave the Sherman Act a most extreme interpretation.

This stage in the attitude of the courts toward mergers ended, and the present era began, with the decision of the Supreme Court on the appealed Tobacco and Oil cases in 1911. Although both cases were decided against the defendant companies, the doubtful issues involved were so ably clarified by the Court that the business world felt a distinct sense of relief. Legitimate business, which had not surely known where it stood as regards merging, was made to feel far more secure than before in the light of the declaration by the Court of the principles involved.

In those cases the Supreme Court announced the "rule of reason" under which, in considerations having to do with the anti-trust laws, business has since operated.

The three principles involved in the "rule of reason" are well worthy of careful noting by business men.

The first may be said to be, that a consolidation of competitors is not of itself necessarily unlawful merely because it would eliminate competition between the companies involved. This was of the greatest importance to business.

The second principle laid down was in effect that the particular form or make-up of a merger did not affect its legality from the anti-trust law point of view. Thus it is not necessarily illegal for one company to buy the capital stock of another even if that other be a competitor.

The third principle was that the intent of those involved in or responsible for a merger was to be

taken into consideration—in fact was to be one of the criteria of the legality or illegality of the merger. The Court gave as its reasons for the decision:

"Because the unification of power and control over petroleum and its products, which was the inevitable result of the combining . . . of so many other corporations . . . gives rise . . . to the *prima facie* presumption of intent and purpose to maintain the dominancy over the oil industry, not as a result of normal methods of industrial development but by new means of combination which were resorted to in order that greater power might be added than would otherwise have arisen . . . the whole with a purpose of excluding others from the trade. . . .

"Because this *prima facie* presumption of intent to restrain trade and to monopolize . . . is made conclusive (1) by considering the conduct of the persons who were mainly instrumental in bringing about the expansion of the New Jersey Corporation before the consummation of that result . . . (2) as well as by weighing the modes in which the power vested in that corporation has been exerted and the results which have arisen from it."

Thus if a merger has for its intent and purpose the formation of a monopoly which shall keep out all competitors and oppress consumers through high prices or otherwise, it is unlawful. In determining what the intent is the court may consider evidence as to, first, the proportion of the total production of an industry controlled by the merger; second, the effect of the merger upon prices; and third, the attitude and action of the merger toward competitors.

In fact, the court may consider any evidence which throws light upon the question of whether the merger is primarily for the purpose of securing perfectly proper advantages such as greater economy or whether it is seeking such absolute control as will enable it to oppress the people.

Thus there is apparently no limit to the size of an industrial merger so long as it has no evil or illegal intentions.

While there have been some modifications from time to time in later decisions, these by the Supreme Court which laid down the now famous principles of the "rule of reason" cleared the air and those principles still stand in their essentials.

During the next few years, several cases were decided by the Supreme Court which clarified the principles of the "rule of reason" and gave business a safer and more certain basis for proceeding in the formation of mergers. These were the du Pont case, the Reading case, the Union Pacific case, the St. Louis Terminal case, the United Shoe Machinery case, the National Cash Register case, the Keystone Watch Case Company case, the Eastman Kodak Company case, the Corn Products Refining Company case, the American Can Company case, the United States Steel Corporation case, and the International Harvester Company case.

The findings and opinions of the Court in some of these cases may well be cited as they throw considerable light on the present status of mergers before the law, as well as of the state of public opinion on the merger question.

Thus the Court ordered that the du Pont Company be dissolved, although it controlled only a little more than 70 per cent of the business in ordinary explosives other than smokeless military powders (of which it was the sole manufacturer) chiefly on the ground that it had used improper means to keep competitors out of the field.

Again, the Court found that the Reading Company controlled two competing railroads as well as two large competing anthracite coal companies. It said, "This dominating power was not obtained by normal expansion to meet the demands of a business growing as a result of superior and enterprising management, but by deliberate, calculated purchase for control. That such a power, so obtained, regardless of the use made of it, constitutes a menace to and an undue restraint upon interstate commerce within the meaning of the Anti-Trust Act, has been frequently held by this Court."

The United Shoe Machinery case threw light on the attitude toward mere bigness. The Court said:

"The company indeed has magnitude, but it is at once the result and cause of efficiency, and the charge that it has been oppressively used is not sustained. Patrons are given the benefit of the improvements made by the company and new machines are substituted for the old ones without disproportionate charge. There has been saving as well in the cost of manufacture of shoes."

Again the Court said, "On the face of it the combination was simply an effort after greater efficiency. The business of the several groups that combined,

as it existed before the combination, is assumed to have been legal . . . and it may be assumed that the success of the several groups was due to their patents having been the best. . . . It is said that from 70 to 80 per cent of all the shoe machinery business was put into a single hand. . . . But taking it as true, we can see no greater objection to one corporation manufacturing 70 per cent of three non-competing groups of patented machines collectively used for making a single product than to three corporations making the same proportion of one group each."

Also in the shoe machinery case the Court made a decision which has a strong bearing on the legality of the so-called "circular" mergers which we are prone to think of as something new, although they are not by any means. The Court held that it was perfectly legal for the Shoe Machinery Company to buy concerns making related products such as eyelets, shoe brushes and blacking, shoe trees, sandpaper, needles, awls and so on. By being able to supply the trade with a complete line of the goods it used the company was serving the trade more efficiently, the Court held.

The government's principal objection to the National Cash Register Company was that it had suppressed competition by methods which were illegal. It charged that it had driven competitors out of business chiefly by means of patent infringement suits which were not always in good faith but rather aimed to wear out or intimidate weaker competitors. Other alleged methods set forth in the indictment

were organizing bogus competitors, tampering with mechanisms of competitors' products, interfering with competitors' sources of supply and of credit and many others.

The Court held that such methods were clearly a violation of that section of the Sherman Act which forbids monopolizing. Upon the Cash Register Company agreeing to discontinue such practices the government withdrew its suit and the company was not dissolved.

In the Keystone Watch Case Company case, two points were brought up—first whether the consolidation of several companies into a merger which thereupon has a dominating position in the trade is in itself a violation of the law, and, second, what constituted restraint of trade.

On the first point the Court said of the Keystone Company, which did from 50 to 55 per cent of the business in its field, in 1903, "Up to this time we discover nothing unlawful in the operations of the Keystone Company. No doubt it has been growing, and it has grown in part by acquiring or controlling several other plants; but it had not acquired them by improper methods and it did not use its acquisitions improperly . . . its plants were enlarged or improved, the volume of production was increased, prices were not inflated, competitors were not unlawfully attacked, and we find nothing in the evidence that would justify us in condemning the foregoing steps in the company's activity. A merchant may without offense add one department to another as his business prospers or his ambition expands;

for the size and varied character of his activities do not in themselves violate the Anti-Trust Act. Size does not of itself restrain trade or injure the public; on the contrary, it may increase trade and benefit the consumer; but if the power given by the volume of a particular business is improperly used to injure either a competitor or the public . . . the mischief either done or threatened is condemned by the statute."

On the complaint alleging restraint of trade it was shown that the defendant had attempted to fix resale prices of its products and to force the jobbers to buy watch cases of its make exclusively. It was held that this was plainly restraint of trade. In the opinion of the Court, "Trade is restrained by putting hindrances in the way of the persons that conduct it. . . . (1) Competitors must not be coerced; (2) prices must be arbitrarily fixed or maintained; (3) an artificial scarcity must not be produced; moreover, the public is also injured if quality is impaired . . . if the wages of the laborer be arbitrarily reduced, and if the price of raw material be artificially depressed."

In the Eastman Kodak Case the government contended that the company's control of some 80 per cent of the photographic material business was achieved by illegal means. It held a monopoly, the government alleged, on the supply of a special raw paper stock imported from Germany, it followed a definite policy of acquiring every dangerous competitor, of putting erstwhile competitors under contract not to reenter the business, to close plants

when it seemed advantageous to do so, and to require that its distributor customers deal exclusively in Eastman products.

In entering a decree of dissolution against the company the Court said, "There is no limit in this country to the extent to which a business may grow, and the acquisitions of property in the present case, standing alone, would not be deemed an illegal monopoly; but when such acquisitions are accompanied by an intent to monopolize and restrain interstate trade by an arbitrary use of power resulting from a large business to eliminate a weaker competitor, then they no doubt come within the meaning of the statute."

The courts upheld the contention of the government that the Corn Products Refining Company was a combination in restraint of trade on the following grounds:

1. Securing rebates from railroads which gave it an unfair competitive advantage;

2. Control of prices and production;

3. Allowing discounts based upon purchases to customers who agreed not to use competitive products;

4. The purchase of a candy manufacturing company which sold candy at less than cost in competition with candy manufacturers who made glucose in competition with the Corn Products Refining Company;

5. The formation of fake independent companies which sold at discriminatingly low prices

to buyers who patronized competitors of the Corn Products Refining Company.

In the American Can case the Court differentiated between those methods and policies in use which were in illegal restraint of trade and those which indicated merely an intention to improve its efficiency and the general conditions in the can industry.

It held illegal the company's control of can-making machinery, which until the contracts expired some years before had made it impossible for competitors to utilize the machines except upon highly discriminatory terms. It also classed as unlawful the company's arrangements for special discounts on tin plate, the municipal raw material, the contracts with customers which required them to take all of their season's requirements from the American Can Company, and the use of fake independents to undersell competitors in certain territories.

On the other hand, the Court approved of the fact that the company had by various means stimulated a friendly feeling in the industry largely by its work in studying the problems of the canners and by its activity in standardizing the sizes of cans with resultant benefit both to the can makers and to their customers.

It was found that in spite of its unfair methods of competition in some respects the prices of cans had not been unreasonably increased. The company had worked out improvements both in the types of cans and in methods of can manufacturing which were for the ultimate good of all concerned. Fur-

thermore, by locating its plants at strategic centers, the Court held, the company had benefited its customers through its ability to serve them better.

The Court apparently felt that the benefits brought by this trust outweighed the harm, especially inasmuch as many of the objectionable methods had been discontinued prior to the hearing of the suit. It declined to dissolve the company. The government appealed but withdrew the appeal when the Supreme Court's decision in the United States Steel Corporation case settled the points in question.

The United States Steel Corporation was, to quote a judge of one of the lower courts, "a combination of combinations by which, directly or indirectly, approximately 180 independent concerns were brought under one business control, which, measured by the amount of production, extended to 80 per cent or 90 per cent of the entire output of the country."

In its decision in favor of the Steel Corporation the Supreme Court laid down the important principle, under the "rule of reason," that although a merger may have been put together in violation of the Sherman Act it may, if it change its policies and methods, avoid dissolution under that law.

So although the Steel Corporation was, according to the finding of the Court, formed with illegal intent, it did not, to quote the opinion, "at any time abuse the power or ascendency it possessed:

"1. It did not secure freight rebates;

"2. It did not increase its profits by reducing the wages of its employees;

"3. It did not increase its profits by lowering the quality of its products;

"4. Nor create an artificial scarcity of them;

"5. It did not oppress or coerce its competitors;

"6. It did not undersell its competitors in some localities by reducing its prices there below those maintained elsewhere;

"7. Require its customers to enter into contracts limiting their purchases or restricting them in resale prices;

"8. It did not obtain customers by secret rebates;

"9. There was no evidence that it attempted to crush its competitors or drive them out of the market;

"10. Nor did it take customers from its competitors by unfair means."

In the International Harvester case the Court carefully went into the business policies and methods of the merger and found them not to be illegal. The principal points in favor of the International Harvester Company are covered by the following excerpts from the Court's opinion:

Building up a full line of farm implements, according to the Court, "led to cheaper production and distribution and had brought about a change in competitive conditions affecting generally all their lines."

"It does not appear that the International Harvester Company has used its capital and resources (though greater than those of all its competitors combined) or its subsidiary companies or incidental advantages for the purpose of, or with the effect of,

restraining or suppressing the interstate trade in harvesting machinery."

It was found that the company had not cut prices below cost at any time, and, on the other hand, it was not shown that it had in any way attempted to fix prices. "The fact," said the Court, "that competitors may see proper, in the exercise of their own judgment, to follow the prices of another manufacturer, does not establish any suppression of competition or show any sinister domination."

And perhaps of broadest basic importance was the statement by the Court, "The law . . . does not make the mere size of a corporation, however impressive, or the existence of an unexerted power on its part, an offense, when unaccompanied by unlawful conduct in the exercise of its power."

It is well to remember that, while until 1913 the only anti-trust law was the Sherman Act passed in 1890, Congress has since then passed nine others some of which tighten the requirements but many of which legalize certain immunities to specified business, such as banking, from the early stringent requirements of the law concerning restraint of trade.

Those which directly affect the status of industrial mergers in their interstate and foreign trade are the Clayton Act and the Webb-Pomerene Act.

The important feature of the Clayton Act as it affects industrial mergers is that it "puts teeth" into the Sherman Act.

The Webb-Pomerene Act legalizes "an association entered into for the sole purpose of engaging in export trade . . . or an agreement made or act done

in the course of export trade by such association, provided such association, agreement or act is not in restraint of trade within the United States, and is not in restraint of the export trade of any domestic competitor of such association."

In the light of the preceding discussion of laws and of the opinions of the courts on various phases of the anti-trust laws, it would seem that it should be possible to summarize quite definitely and successfully the status of any industrial merger from a legal point of view.

Unfortunately that cannot be done. The nearest that we can come to it is to state the present attitude toward mergers. As we have seen, a law which like the Sherman Act is stated in general terms is, so long as it remains a live law, generally interpreted by the courts in the light of the prevailing public opinion.

There can be little doubt but that public opinion at present has lost much of its fear of mere size in a business. What it fears, rather, is misuse of the power which great size gives, to the end of preventing freedom of trading, through making it impossible, by fair means or foul, for competition to arise and succeed in the fact of monopoly.

This is shown by the prosecutions brought by the government under the anti-trust statutes.

From 1890 when the Sherman Act went into effect, until 1927, only a fraction less than 22 per cent of the suits brought by the government were based chiefly upon the fact that the defendant was a consolidation of competitors. Still more significant is

the fact that although, in the early stage of the anti-trust laws from 1890 to 1917, 37 8/10 per cent were on primarily the grounds of merger, in the next ten years merger as such accounted for only 7.6 per cent. That indicates a trend in public opinion away from the idea that size alone is something to be feared.

As a matter of fact, there can be no doubt that the ablest business men have learned that unfair, unscrupulous and predatory attacks upon competition are nowhere nearly as effective in making profits as skillful, economical operation. It may be that business men have suddenly seen the light and become converted to a high standard of business ethics, or, as seems more likely, it may be merely enlightened self-interest that dictates today's policies and methods. However, it is a fact apparent to the thoughtful observer that unethical practices are far more common in small business than in big business.

Generally speaking, the courts seem to understand that modern business mergers are most often formed for the sake of realizing perfectly proper advantages, usually in the way of economies of production, distribution and administration, and that these advantages redound not only to the benefit of the consolidations but to that of their employees and customers—which is to say, the general public.

Commonly, therefore, the mere size of a merger or the extent to which it controls the total production of an industry is not a criterion of whether the merger is legal or not. Rather does the court base its findings upon the basic object of the merger and

its behavior toward customers, competitors and employees.

Of late it has become rather common practice for the sponsors of a proposed merger to submit their plans to the Department of Justice for an unofficial opinion as to the probable legality of the merger. Such opinion is usually freely given, but it does not prevent the government from initiating suit later.

On the whole it can be safely said that under the present state of public opinion even competitors can safely merge, provided they are prepared to show that they have no illegal intent and that they have reason to believe that as a result of merging they will be able to render better service at no higher price than they could as independent concerns.

CHAPTER X

Where is the Merger Movement Leading?

STATISTICIANS of a speculative turn sometimes project their curves far into the future and tell us what the world will be like in those distant years. By this means they undertake to foretell what the population of the world will be, how many telephone subscribers there will be in the Fourth Ward and when the circulation of a fledgling magazine will outstrip that of some long established rival.

Were we thus to project a curve setting forth the number of mergers formed in recent years it would appear that before many years all American business worth mentioning will be done by a single mammoth corporation which will sell us everything from bread and butter to battleships and perform all services from shaving us to supplying us with electricity. There, with nothing left to merge, would be the answer to the "whither-are-we-drifting" nuisances who seem perennially to concentrate their attention and questions on the merger problem.

To our recollection not even the most imaginative and easily alarmed of our "progressive" Senators have conjured up such a super-super-merger. So far they have stopped at a super-power octopus, a food trust or some other giant consolidation which

would embrace an entire industry—but be pretty much confined to that industry.

Although, of course, such a development is remote and unlikely, there is probably no business reason why an ultimate merger of all concerns in all industries is impossible. We have passed the "Shoemaker, stick to your last" phase of business. There are many men who have demonstrated their ability to manage, with suitable help, highly diverse enterprises. In fact, one of the most potent discoveries of modern times was that all businesses are basically much alike and that therefore a man who succeeds in a big way in managing one business can almost certainly repeat his success in one widely different. Thus, in recent years we have seen a successful public utility man called upon to rejuvenate a failing leather company and, having done so, move on to head a big merger in the amusement field.

Judge Gary demonstrated his ability to lead on to fortune a loosely knit and overcapitalized aggregation of ore and coal mines, railroads, steamships, steel mills, wire mills and bridge companies. With proper help, it is entirely likely that he could have taken on the management of General Motors, Allied Chemical & Dye, General Electric, several public utilities and an assortment of nation-wide dairy products, baking and chain store consolidations.

A super-merger doing all of the business there is to do seems much more feasible now than it would have even a few years ago. Then a business was commonly headed by a "practical" man—a tanner, a steel maker, a baker or whatnot. There was little

interchange of knowledge about management methods and there was nothing that could be called a science of either management or business administration. Today we have a veritable army of engineers versed not only in technical but in management methods. And every year a hundred or so colleges are turning out well-educated men who have specialized in business administration and who as cubs fresh from college often know more about business fundamentals and management methods than did their fathers after a lifetime spent immersed in the details of a business.

Grant that probably only a few of these youngsters are endowed with great natural qualities of industrial leadership, nevertheless, they constitute a large and well-equipped potential supply of seconds in command—plant managers and sales managers, comptrollers, division superintendents and presidents of subsidiary companies.

Whether a business is large or small its success depends ultimately upon the skill of its management. One important reason why so many mergers of thirty or forty years ago failed was because management talent was not only scarce but usually narrow and, by present standards, crude and unskilled. Today we have more managers and they are better trained and more skilled. Inability to find suitable men for the management is no longer an insuperable obstacle to an ultimate super-merger, in spite of the often reiterated statement of those who do not always know exactly what they are talking about.

The statement is often made that it is possible

for a business to become so big that no one man can manage it. That is given as a reason why so many mergers have failed, with complete disregard of the easily demonstrable fact that our largest companies are the most successful. To point to the failure of a few of second or third magnitude as evidence that they were too big to be managed is ridiculous on the face of it. All it proves, if mismanagement was the cause of failure, is that those particular concerns were unfortunate in choosing their managers. Others, much bigger, were sailing along smoothly under capable skippers at the very moment these were going under.

Granting that really big men are somewhat less numerous than blades of grass, they yet exist. And it is logical that what man can design and put together in the way of gigantic business mergers, man can manage.

The argument is frequently advanced that this is an age of specialization and that to succeed a business must specialize. As an argument against the super-business that is sheer nonsense. Specialization is essential, of course, but the specialization can be and is left to the smaller units of a business. Thus a factory may well specialize on a single product—just as the plant itself is made up of still more highly specialized departments.

But it is not necessary to theorize. There are plenty of concrete examples of mergers made up of concerns in widely different industries. General Motors does a creditable job of making and selling not only automobiles but refrigerators and house

lighting plants. Lately it has decided to go into the selling of radios.

The Glidden Company, originally a maker of paint and varnish, has done so well in producing margarine and coconut oil that it is rapidly—and confidently—branching out into the production and sale of a variety of other food products by the merger route.

We may be accused of inconsistency in saying that such a merger of unrelated companies might possibly be the ultimate development in American business. For several times we have spoken and written disparagingly of certain ill-assorted businesses. The point made is, that such diversified groups should generally not be the first step in consolidation. They should come, if at all, as a later development.

With the distinct understanding that we are not undertaking to foretell the future but that we are, rather, amusing ourselves momentarily with the pleasurable self-indulgence of letting the imagination range, hampered only by known facts and plainly observable present trends, let us consider what the business world would be like in the remote event that all businesses finally should become grouped into one.

Even though such a super-merger succeeded in corralling all of the then existing business, it does not follow that from time to time new independent businesses would not crop up. Inventors would continue to devise wholly new products and new ideas would still spring into being.

Some of these would be financed independently, for the super-corporation would not always see fit to exploit the new developments. Men's minds differ and the majority would continue on occasion to say, "It can't be done," to a minority who would proceed to do it. Some of these new things would prove themselves and ultimately be purchased by the super-corporation.

Why, it may be asked, should the inventors be willing to sell? Because the super-corporation could distribute and probably produce more cheaply and because its stock with which it could buy the new business would pay more than the little company's stock.

Even though the original owners of the independent concern should cherish their independence more than profits, some day death or lessening profits would bring about the inevitable sell-out.

The operating organization of such an all-inclusive business would not present insuperable difficulties. In fact, to the casual observer there would probably be few signs that any particular business was a part of a super-merger. Even to the rank and file of employees today there is little to indicate in their daily affairs whether they are working for a merger or for a small independent business.

Most of the changes would be internal. Definite channels for the flow of goods would be set, and the accounting of similar or closely associated companies would doubtless be consolidated to a large extent.

There would obviously be a complete vertical consolidation from raw materials to the retail store

for the production and distribution of consumer goods. For the production of other goods, such as steel, copper, machinery and so on, there would also be vertical integration. A merger in the steel industry announced late in 1929 carries some of its processes clear through from the rawest of raw materials to the finished product ready for the ultimate consumer.

It is well to remember that in such a universal corporation there would be no question of one unit being owned by another—no owning of stores by a manufacturer or vice versa—as there must so often be in the present stage of business.

Just what the ultimate line-up might be can, of course, only be guessed at. All of the various big baking companies might well be under one management. The same might be true of the cotton industry. On the other hand, it might be more logical to have specified groups of cotton mills each concentrating on certain specialties which they would furnish to the retail stores. Other groups, then, would concentrate on other fabrics used by industry, such as for tires, awnings, sacking and so on.

To attempt to set up the best possible organization ready-made would be difficult. The best way would be by experience on a smaller scale—and that experience we are now getting.

There would doubtless be wide use of incentives for management in order to secure the attention and interest that is usual with owners but often so difficult to get from hired men. Yet this has been no-

tably achieved by one of our larger businesses—the General Motors Corporation.

Think of the economies that would result from such a coordinated business world. There would be no selling expense except at the retail counter; no competition; no credit losses except on retail sales; no duplication of expense for research and for many executive functions. Even the bad debt losses could be all but eliminated inasmuch as most if not all of the super-mergers customers would also be its employees. Their purchases could be charged against their wages.

Again let us emphasize that we are not prophesying that this complete integration of all business will come about. But it is within the realm of possibility.

As an investment banker, one would not like to see it develop—as a consumer it would be welcomed. It is doubtful whether such a universal monopoly would have much need for investment bankers. It could, like some of our present big corporations, handle its own financing.

There need be no fear that such a monopoly would put the screws upon its employees and customers. It would keep wages high and prices low, for people on starvation wages or those compelled to pay unduly high prices are not big consumers—and business men big enough to manage such a merger understand that. The economies possible in such a combination would make feasible higher wages and lower prices than now seems possible.

Furthermore, such a company would not be owned

by a small, powerful group although its basic policies would be dictated by a few of the ablest minds in the country. The ownership would be in the hands of the millions. Every present holder of any kind of non-government security would own stock in it. Many millions who are not now security owners would, because of their greater margin of income over outgo, invest their surpluses in its stock. Everybody would be working for the same company and everybody would own a share of that company. It would, therefore, in effect be socialism arrived at not by political change but by capitalistic evolution.

So much for the possible, but highly unlikely ultimate development of the single super-merger.

The probabilities are, however, that, over a period of years, more and more mergers will be formed. Rapid and extensive as the merger movement has been there are still vast numbers of companies as yet independent, to say nothing of small mergers that might well combine. There are literally thousands of logical mergers that could be formed and that doubtless will be formed, sooner or later.

It is unlikely that the formation of mergers will progress at a uniform pace. There will be periods favorable to consolidation when the pace will be rapid. There will be other times when for one reason or another the progress will be slow. There have always been such fluctuations and there is every reason to believe that there always will be. The story of these recurring cycles in merger formation is told briefly in Chapter II.

The attitudes of the public, the law makers and

the courts have, however, a powerful influence in stimulating or retarding business consolidations. Sometimes the effects of laws are not easy to foresee. Thus the Clayton Act, designed to insure fair competition and to some extent to hamper the activities of mergers, actually stimulated merging, according to many lawyers. It put restrictions upon the things independent competitors could do by agreement among themselves, and so forced them to merge so that they could do legally as a merger what would be illegal for them to do unmerged.

Even the income tax law had its effect. Originally when the stock of a merger was exchanged for the stock of an independent company the stockholder was taxed on the transaction. That dampened the ardor for merging. But when about 1920 the ruling was made that under certain circumstances such exchanges of stock were not taxable, many desirable mergers that had been shelved for some time were consummated.

The attitude of the Department of Justice and of the courts has a direct and strong influence upon the formation of mergers. As this is written there are indications that these factors may become less lenient. Several suits and investigations are threatened. If it is found that there has been too much leniency in the government's policy under the law, there doubtless will be hesitancy on the part of business men to take chances on the putting together of mergers that they would have felt perfectly safe in sponsoring only a few months previously.

Financial and business conditions, also, have a

great influence. When the public has plenty of money for investment, or when there is a relatively short supply of securities for sale, is generally a propitious time for floating a new merger. On the other hand, when the public has been severely drubbed by a declining market it habitually nurses its wounds and for a time avoids investing in new securities. At such times plans for mergers that require outside financing are usually held up. However, if there is to be no new financing and merely an exchange of securities there is no reason why the merger cannot be consummated. In fact, it may be highly desirable to go ahead in order to secure the economies of operation that are of such great importance in times when business is dull.

Hence, making allowance for all of the factors mentioned, the probabilities are that, left to itself, business will more and more group itself in mergers. Rapid and extensive as has been the movement there is plenty of merging yet to be done.

The very formation of a merger of even reasonable size and strength is itself a powerful stimulus to the formation of others. When several competitors get together to form a horizontal merger the remaining independents must usually in self-defense band together or the struggle will be too unequal. Even more is this true when a merger is formed along more or less complete vertical lines. Soundly put together and skillfully managed, the possibilities of economies are so great as to provide a price advantage all but insuperable to other concerns less well integrated.

Wherever you find one large merger in an industry you usually find one or more others that were formed later. Consider the steel, the baking, the radiator, the automobile, the leather industries, among others. It is not alone to achieve the ability to compete that accounts for the stimulus which the formation of one merger exerts on the formation of still others.

There can be little doubt but that the formation of huge chains of retail stores has so increased buying power, that those companies which sell to the chains have in many instances been forced to combine in self-defense. Between a small manufacturer and a large retailing company the struggle is too unequal. This also holds true between manufacturers, and in cases between manufacturers and wholesalers.

The reverse has doubtless also been the case. That is, small concerns buying from a large merger find themselves at a disadvantage in bargaining, and get together in a merger primarily so that they can put up a strong, united front when going to market.

This process has no apparent limit. Starting with a consolidation of small units, a merger may find itself doing quite well until as a countermove several of the merger's customers, or suppliers, try for a greater advantage and form a merger of mergers. The other side counters with another merger of mergers. And so on.

Many of our largest corporations are themselves mergers of mergers and this is a trend which is be-

coming more pronounced as the merger movement attains momentum. It is not at all difficult to visualize an ultimate merger of all units in an industry having complete control of that industry provided, of course, the law does not step in and stop the integration process. In fact, in some industries not much merging remains to be done before this condition is accomplished. It is particularly easy to conceive of such mergers in certain industries such as steel, leather, electrical equipment and many others where there are already only a few companies and those large.

The trend toward mergers of mergers is also marked among retail chains and in the food products industry. The Borden Company, Kroger Grocery and Baking Company, General Foods Corporation (formerly Postum) and many others have been acquiring additional concerns rapidly of late.

Even after its great expansion by purchase of existing businesses during 1928 and 1929 the Borden Company in July, 1929, had signed contracts to acquire no less than 32 other companies of which seven have a total of 20 subsidiaries.

There are already several chains of department stores which came into existence by the merger route and more are in prospect. As these reach a proper size it will be a logical, in fact, an almost inescapable, development for them to acquire manufacturing plants to supply a large part of their needs—ultimately perhaps all of the goods they sell. When well-integrated, gigantic retail mergers of this sort

find themselves in competition in various towns it will be but natural for them to get together.

Whether in manufacturing, retailing or in public service, it is evident that merging of mergers is a natural tendency and one which is well under way. Where it may end no one can safely say. Of one thing we may be sure. The economic reasons for merging are so sound, so compelling, in fact, that left alone by the courts and by Congress it is quite certain that merging will continue to be done. It seems all but certain that twenty-five years hence we shall see fewer concerns doing the business—but they will be far larger than even the largest of today.

CHAPTER XI

Brief History of Merger Movements

MERGERS have been formed to a greater or less extent at all times during the past forty or fifty years, but there have been three distinct periods in American business history when the formation of industrial mergers proceeded at an unusually rapid rate. Each of them coincided with a period of great business expansion, and activity in security speculation, especially on the part of the public. The first two merger eras ended with the coming of general business depression—due partly to the failure of existing mergers and partly to a sated appetite on the part of investors which made it all but impossible to sell merger securities.

The three eras can be roughly identified as from 1879 to 1896, from 1896 to 1903, and from 1903 on. Let us consider them in broad detail as all periods present certain traits in common and each had certain peculiarities all its own.

The first period is often called the "trust forming era" because of the fact that a large part of the consolidations were of the trust form. Its beginning can be conveniently set as 1879 when the Standard Oil trust was formed.

So successful was this trust in controlling production and prices, in stabilizing the petroleum industry and in effecting economies that we find many other

industries following Standard Oil's lead during the next fourteen years, some taking the trust and others the corporate form. Among the more important mergers formed prior to 1894 were the United States Leather Company, the Diamond Match Company, the General Electric Company, the United States Rubber Company, the American Tobacco Company, the National Lead Trust, the Whiskey Trust, the Sugar Trust, the Linseed Oil Trust and the Cottonseed Oil Trust.

Some of these mergers have been highly successful; others had hard going. Mostly they were formed for the avowed purpose of securing a monopoly which, by eliminating the viciously prosecuted competition that was then the rule in American industry, would enable prices to be maintained at a high level. It is notable that most of the mergers of this era were formed by the men in the industries themselves and usually not by professional promoters.

With the general business depression of 1893 the formation of mergers came to a practical standstill. It would seem logical that during times of depression, when competition is especially severe, business men would be driven to combine, but history shows the contrary to be true. Merger forming then languishes and revives only when business begins to pick up.

During the three years of depression, 1894, 1895 and 1896, no combinations of importance were formed although a few of the earlier ones were reorganized.

During this period many suits were being brought against the trusts under the anti-trust laws and there was, no doubt, a degree of hesitancy on the part of business men which led them to take a position on the side lines until the air cleared and it became more certain just what it was legal for them to do along merger routes. It is hard to appraise the relative importance of these two factors—business depression and federal prosecution. There can be no doubt that the attitude of the courts was an influence, yet the fact that business depression always halts merger formation while prosperity stimulates it can hardly be dismissed as mere coincidence.

Largely due to a narrow interpretation of the law by the Supreme Court and the failure of states to enforce their local anti-trust laws in 1895-96, it began to look as though it were reasonably safe to form mergers. Yet, due to the depression, there was no revival of trust forming activity until after the election of President McKinley and the revision upward of the tariff. Thus was ushered in a period of great prosperity during which the formation of new mergers proceeded at a still more rapid pace.

According to the census of manufacturers of 1900 there were formed in the first period running from 1879 to 1896 only 18 mergers whose capitalization was ten million dollars or more. Only 12 of those early mergers were of any great importance.

So marked was the "trust movement" after McKinley's election that on January 1, 1904, there were in existence, according to John Moody, 318 industrial combinations. Eighty-two of these had been

formed prior to 1898, and 234 in the years 1898 to 1903, inclusive.

Those were highly prosperous years of large exports, large crops sold at high prices and generally active business. These conditions were reflected in the security markets. This became more marked when McKinley was reelected in 1900. There was feverish speculation at increasing quotations in stocks. The time was ripe for the formation of mergers and the disposing of their securities to the public.

This opportunity was seized upon by professional promoters who saw a chance for juicy profits. But it was short. The Northern Pacific panic deflated the stock market, and it began to be apparent that some of the ill-advised or unsoundly put together mergers were not so successful as it had been thought they would be. Public confidence in the magic of mergers was shaken and it became difficult to market their securities. It has been said that the panic of 1903 was due to undigested securities. It was true that more than one banking house found its shelves stocked with merger securities which it could not move. It is said that the market values of the securities of a hundred principal mergers shrank in market value 47 per cent between 1900 and 1903.

The great stimulus to merger formation during the second era came from professional promoters, who generally found business men willing to listen as a result of the devastating competition they had experienced during the depression that began in 1893. These promoters were shrewd, plausible and

agressive. Unfortunately many of them were concerned solely with their own immediate profits and gave little thought to the future of the organizations they were putting together. It was during this period that the Glucose Sugar Refining Company was formed out of six competing companies; the Corn Products Company, out of the National Starch Company, the Glucose Sugar Refining Company and three independents; the National Salt Company out of 12 companies; the American Bicycle Company, out of 48 competitors which controlled 900 patents and did 65 per cent of the total business; the American Malting Company, comprising 22 competitors; the New England Cotton Yarn Company; the Asphalt Company of America, and others.

There was comparatively little activity along merger lines from 1903 to 1921. Mergers there were, of course, but they were mostly small and unimportant. The activity in the third era really started about 1922. Again it was a period of prosperity, of stock market activity, of increasing efficiency of production and above all of increasing per capita consumption. In fact, this was often declared to be a new economic era when the old rules were no longer valid. From a general business standpoint the stage was perfectly set for a revival of interest in merger formation.

Furthermore the courts and the lawmaking bodies hastened along the movements. Some time before the Supreme Court had declared for the "rule of reason," which has been discussed in Chapter IX.

The Clayton Act, aimed at preventing abuses and

especially designed to strengthen the Sherman Anti-trust Law, turned out to be a strong stimulus to the formation of mergers. Shrewd lawyers soon found that acts which independent competitors could not legally perform, could be done legally if the competitors got together in a merger. Some authoritative observers consider that this was the biggest element in the revival of merger formation.

Another element was the ruling of the Treasury Department making exchanges of securities in merging non-taxable under certain conditions, whereas under the original tax law they had been subject to tax. This has undoubtedly removed a serious obstacle to the formation of mergers, in that the owners of small companies were formerly often penalized by having to pay taxes on a paper profit.

During the seven years up to 1930 probably thousands of mergers have been effected. It was a poor month in 1928 and 1929 when from twenty-five to fifty mergers were not announced. Granted that in this period few basic consolidations such as those of the first two eras have been formed. But there have been many acquisitions of one concern by another and a great deal of merging along circular and vertical lines.

Monopoly is no longer given as a reason and it is doubtful if it is often in the minds of the business men involved. The real reason is usually the securing of economies of one sort or another and, as we have seen, the economies are achieved more often than not.

There can be little doubt that the present merger

movement is sounder than any that has gone before. If the next few years prove this to be so we can doubtless expect to see merging continue, for there is still plenty that can be done in spite of the statement made by a prophet shortly after the formation of the United States Steel Corporation, that "there is nothing left to merge."

INDEX

A. & P., 23
  retail units of, 10
AC Spark Plug Co., 119
Administration, reduction of costs, 3
  economies of mergers, 73 *et seq.*
Advertising costs, reduction by horizontal merger, 62
Air Reduction Co., 125, 135
Allied Chemical and Dye Corp., 135, 181
Allis-Chalmers Mfg. Co., 135
American Bicycle Co., 198
American Brass Co., 27, 31
American Bridge Co., 23
American Can Co., 135, 167, 173
American Malting Co., 198
American Management Association, 151
American Radiator Co., 13, 15, 21, 121, 141
American Radiator & Standard Sanitary Corporation, 10, 15, 20, 45, 61, 72, 120, 142
American Steel and Wire Co., 24
American Sugar Refining Co., 29, 163
American Tobacco Co., 135, 164, 195
American Writing Paper Co., history of, 4, 135
Anaconda Copper Mining Co., 27, 31, 46, 125, 135
Argonaut Realty Corp., 118
Asphalt Co., 198
Assets, decreasing importance of, 105
Baker Co., Franklin, 68
Baker & Co., Walter, 68
Bethlehem Steel Corp., 135
"Big" business, assets and liabilities of, 9
  public antagonism to, 144
Birdseye process, 68
Bond issue, when undesirable, 127
Bonds, trend to invest in, 109
Borden Co., 125, 135, 192
Brown, Donaldson, vice president of General Motors, 150
  on working of General Motors, 151 *et seq.*
Brown-Lipe-Chapin Co., 115, 119
Buick Motor Co., 115, 118
Business unit, definition of, 10
  "best size" for, 10

Cadillac Motor Car Co., 115, 119
Calumet Baking Powder, 68
Campbell Soup Co., 29
Carnegie, Andrew, 126
Carnegie Steel Co., 126
Centralized organization, 155
Chain store systems, increase of, 10
  mergers of, 5
  types of mergers, 22
Chester, Colby M., Jr., on inception of circular merger, 65, 68
Chevrolet Sales Co., 115, 119
Chrysler Corp., 135
Circular merger, 20
  development, 65

examples, 32
explanation of, 14, 32
promise of, 35
purpose of, 39
selling forces reduced by, 70
Claxon Co., 119
Clayton Act, 176, 189, 198
Common stock, 130
proper amount of, 131
Competition, unequal, 8
Consolidation, former reasons for, 3
Consumer, ultimate, 6
Continental Can Co., 135
Corn Products Refining Co., 135, 167, 172, 198
Cotton textile industry, survey of, 88
Cottonseed Oil Trust, 195
Craftsmanship, 9
Credit losses, reduction by merger, 84
Cushman Bakeries, 23

Decentralized organization, 155
Delco-Light Co., 116
Delco-Remy Corp., 116
Delco-Remy & Hyatt, Ltd., 119
Delivery costs, saving through mergers, 59
Depreciation, variations in figuring, 103
Dewey, on most profitable business unit, 10, 15
Diamond Crystal Salt Co., 68
Diamond Match Co., 195
Distribution, comparative inefficiency of, 56
economies, 39, 56 *et seq.*
merger as aid to economy of, 111
reduction of costs of, 3
Distribution costs, reduction of, by merger, 56, 68
du Pont case, 167
Durkee & Co., E. R., 35

Earning power, importance of, 105 *et seq.*
Eastman Kodak Co., 135, 167, 171
Efficiency, increase of office by merger, 84
Ethyl Gasoline Corp., 119
Executive personnel, reduction by merger, 82

Factory and Industrial Management, 148
Farms, operation by manufacturers, 29
Financial structure of merger, 112 *et seq.*
Fisher Body Corp., 116, 152
Fisher Body St. Louis Co., 116
Fisher Lumber Corp., 116
Fleetwood Body Corp., 116
Fleischmann Co., distribution system of, 32
Royal Baking Powder merged with, 32
Flour Mills of America, 135
Ford, Henry, changed policy of, 26
production rigidity of, 11
Frigidaire Corp., 117

Gary, Elbert H., 181
General Electric Co., 76, 135, 181, 195
General Foods Corp., 14, 20, 32, 65, 68, 83, 125, 135, 192
General Motors Corp., 76, 115, 119, 135, 150, 181, 187
foreign sales offices, 117, 118
General Motors Acceptance Corp., 118
General Motors Building Corp., 118
General Motors Export Co., 117
Glidden Co., 21, 34, 184
Glucose Sugar Refining Co., 198

Grape Nuts, 32
Gulf Oil Corp., 135

Hahn Dept. Stores Inc., 135
Harrison Radiator Corp., 117
Hellman & Co., Richard, 68
Holton Richards & Co., 106, *note*
Horizontal merger, 13, 15, 17, 20 *et seq.*
  advertising costs reduced by, 62
  difficulties of, 100
  distribution saving by, 59
Houdaille-Hershey Corp., 32, 135
Hyatt Roller Bearing Co., 115, 119

Independent concerns, merger of, 97, 100
Inland Manufacturing Corp., 117
International Harvester Co., 167, 175
Investment fashions, 124, 130

Jaxon Steel Products Co., 115, 119
Jeffery, William P., 161, *note*
Jell-O Co., 66, 68
Johns-Manville Corp., 135

Keystone Watch Case Co. case, 167, 170
Knox Hat Co., 28, 30, 53
Kroger Grocery & Baking Co., 192

La France Manufacturing Co., 68
Linseed Oil Trust, 195
Loew's Inc., 135
Log Cabin Syrup, 32
Long Hat Store chain, acquisition by Knox Co., 30, 53
Lucky Strike Cigarettes, 63

Management, science of, 37
Manufacturer-retailer merger, 31
Mass production, 47 *et seq.*
Mass purchasing power, 45 *et seq.*
Maxwell House Coffee, 32, 68
McKesson & Robbins, Inc., 61
McKinley, William, 196
Merchandise sales manager, factories run by, 148
Mergers, administrative economies of, 73 *et seq.*
  advantages over small manufacturers, 40
  baking industry, 59
  best plan of, 18
  chain store, 5
  circular (*see* separate item)
  criticism of, 36
  definition of, viii
  distribution economies of, 56 *et seq.*
  failure of old-time, 16
  financial reasons for, 12
  financial structure of, 112 *et seq.*
  flour-mill, 58
  "hell period" of, 16
  history of movement, 194 *et seq.*
  horizontal (*see* separate item)
  importance of skillful management in, 19
  investigation before completing, 92 *et seq.*
  management problems, 136
  mass purchasing power, 45 *et seq.*
  mergers of, 19
  operating economy effected by, 36
  potential future of a, 180 *et seq.*
  production economies, 36 *et seq.*

Mergers *(continued)*
professional promoter of, 101
reasons for, 2 *et seq.*, 91, 103
reasons for failure, 38
reduction of credit losses, 84
reduction of executive personnel by, 82
reduction of production cost by, 38, 43 *et seq.*
requisites of sound, 95
results of (*see* Results of mergers)
three methods of managing large, 149
types of, 20
unrelated business, 34
vertical (*see* separate item)
Minute Tapioca, 68
Modern Housing Corp., 118
Montgomery Ward & Co., 23
Moody, John, 196
Moody's Manual, 120
Mortgage bonds, 132

National Biscuit Co., 46, 135
example of combination merger, 23
National Cash Register case, 167, 169
National Lead Trust, 195
National Salt Co., 198
National Plate Glass Co., 116
National Starch Co., 198
New Departure Manufacturing Co., 119
New England Cotton Yarn Co. 198
New Jersey Corp., 166
North Atlantic Oyster Farms, 68
Northern Pacific, 197
Northern Securities case, 164
Non-productive departments, value of, 75

Oakland Motor Car Co., 115, 119
Olds Motor Works, 115, 119
Operations, economies of unified, 12, 36
Overproduction, 3

Paper Factories Inc., 135
Patents, lack as cause of merger, 14
Personnel, reduction by merger, 139 *et seq.*
Post Toasties, 32
Postum Co., 32, 65, 68
Preferred stock, 129
Production, cost reduced by mergers, 3, 36 *et seq.*, 43 *et seq.*, 53
science of, 37
Promoter, methods of professional, 102
Purity Bakeries, 23

Radio Corp., 135
Reading case, 167
Remington Rand Inc., 135
Results of mergers, dairy, 43
flour mills, 47, 58
forging company, 55
furniture plants, 48
hosiery, 52
lumber dealers, 46
paper mills, 50
steam laundries, 47
Retailer-manufacturer merger, 31
Royal Baking Powder, Fleischmann merged with, 32, 71
"Rule of reason," three principles of, 165, 167

Safeway Stores, Inc., 135
St. Louis Terminal case, 167
Salaries, saving of executive, 78 *et seq.*

Salesmen, duplication of, 57, 58
Securities, fashions in, 124 *et seq.*
Selling costs, reduced by vertical merger, 63
Sherman Corporation, 57
Sherman Law, 161 *et seq.*
Shredded Wheat Co., acquired by National Biscuit Co., 23
Specialization, merging as aid to, 50
Standard Brands, Inc., 32, 71, 135
Standard Oil Co., 164, 194
Standard Sanitary Manufacturing Co., 121
Statistical organizations, for comparing operation costs, 43
Sugar Trust, 195
Super-merger, 100
Supreme Court, decisions of, 163 *et seq.*
Swansdown Flour, 68

Taylor, result of experiments, of, 37
Ternstedt Manufacturing Co., 116
Texas Corp., 125, 135
Trusts, prejudice against, 16

Union Carbide & Carbon Corp., 125, 135
United Cigar Stores, 30
  retail units of, 10
United Motors Service, Inc., 117
Union Pacific case, 167
United Shoe Machinery case, 167
United States Leather Co., 195
United States Rubber Co., 195
United States Steel Corp., 15, 19, 23, 28, 46, 105, 123, 126, 135, 167, 174, 200
United Wall Co., 135

Vertical merger, 6, 15, 17, 20
  advantages, 24 *et seq.*, 54, 64
  reasons for, 6
  selling costs reduced by, 63
Vauxhall Motors, Ltd., 119

Webb-Pomerene Act, 176
Whiskey Trust, 195
Woolley, Clarence M., 141
Woolworth Co., retail units of, 10

Yellow Truck & Coach Manufacturing Co., 119

Putnam
2.25
1-5-31

ISU LIBRARY
3 2792 019 801 459

WITHDRAWN
IOWA STATE UNIVERSITY
LIBRARY

Iowa State University Library
Ames, Iowa 50010